

**Final Report of Commissioned Research**

**Legal Persons and Trusts (Legal Arrangements): Potential  
Abuses for ML/TF and Preventive Measures**

**January 2019**

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## **I. Legal Persons**

### **1. Types and Status of Legal Persons in Korea**

#### **A. Significance and Nature of Legal Persons under the Civil Act**

##### **1) Concept of Legal Persons**

The Civil Act grants legal personhood (legal capacity) to an organization which emerges through social relations as an independent entity, regardless of any increase, or decrease or change in its membership, to recognize it as a subject of rights and obligations. When legal personhood is given to a group of people who join together as an organization for a given purpose (corporations or associations) or to an entity consisting of property dedicated to a given purpose (foundation) in accordance with current laws and regulations, they become a legal person and are referred to as an incorporated association or an incorporated foundation, respectively<sup>1</sup>.

##### **2) Reasons for the Existence of the Legal Person System**

Once legal personhood is recognized, a legal person becomes a subject of rights and obligations in property relations under the law as a natural person does. It is then able to participate in legal transactions as a subject of rights that is independent from its members or contributors.

The background for the establishment of the legal person system is as follows. First, an association serves to facilitate legal arrangements associated with a gathering of people for a common purpose. As for a foundation, property dedicated to a given purpose is separate from other assets owned by contributors to ensure the identity and perpetuity of the property. Unless legal personhood is rejected, a legal person is able to participate in legal transactions as an independent subject of rights, be attributed the rights and obligations of the transactions therein, and assume liabilities only for the property owned by the legal person. This enables employees as members of the legal person not to take responsibility for the legal person's liabilities, thereby drawing a legal distinction between the legal person and its employees<sup>2</sup>.

#### **B. Types of Legal Persons**

##### **1) Public Corporations and Private Corporations**

A legal person can come into existence in accordance with the provision of the law (Article 31 of the Civil Act). Therefore, depending on whether legal persons are established under public law or private law, they can be classified into public and private corporations.

As legal persons under private law, private corporations are not subject to the execution of

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<sup>1</sup> Gwag Yun Jig and Kim Jae Hyung, *General Provisions of the Civil Act [Lecture on the Civil Act I]*, p. 154.

<sup>2</sup> Jee Won-Lim, *Lecture on the Civil Act*, 14th edition, p. 100.

compulsory power of the state with regard to their internal legal arrangements in principle, due to the application of the principle of private autonomy. In contrast, public corporations or legal persons under public law are affected by the state's compulsory power on their internal legal arrangements since they are created to achieve a purpose imbued by the state. Both legal persons under the Civil Act and companies under the Commercial Act fall into the category of private corporations<sup>3</sup>.

## **2) For-profit Corporations and Non-profit Corporations**

Private corporations can be sub-classified into for-profit and non-profit corporations, depending on whether the primary goal is making a profit.

### **A) For-profit Corporations**

As a profit-seeking entity, a for-profit corporation is concerned with its members' private interests. It seeks to provide financial gains for individual members through the distribution of business profit. Even when a corporation is engaged in public works such as transportation, communication, press, and publication, it is deemed as a for-profit corporation when promoting its members' interests through the distribution of business profit to employees.

In principle, a foundation without employees as members cannot be a for-profit corporation. Companies including stock companies under the Commercial Act are the most typical and common type of for-profit corporations<sup>4</sup>.

### **B) Non-profit Corporations**

An incorporated body or foundation relating to academia, religion, charity, art, social interactions, or any other enterprise not operating for profit may be formed as a legal person, subject to the approval of the competent authorities (Article 32 of the Civil Act). Since such a corporation must operate under a purpose other than generating profit, a corporation that also operates profit-seeking businesses is regarded as a for-profit corporation, not a non-profit corporation. However, a non-profit corporation may conduct profit-seeking activities to the extent that is deemed necessary to fulfill the objective of the non-profit organization and does not undermine the nature of the corporation, such as collecting admission fees at an exhibition or accommodating a patient while receiving admission expenses.

Non-profit corporations shall be subject to the provisions regarding legal persons as prescribed in Articles 31 through 97 of the Civil Act.

## **3) Public Interest Corporations under Special Laws**

The Civil Act divides legal persons into for-profit corporations and non-profit corporations, but stipulates no definition of a public interest corporation. However, Article 2 of the Act on

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<sup>3</sup> Jee Won-Lim, *Lecture on the Civil Act*, 14th edition, p. 102.

<sup>4</sup> Gwag Yun Jig and Kim Jae Hyung, *General Provisions of the Civil Act [Lecture on the Civil Act I]*, p. 160.

the Establishment and Operation of Public Interest Corporations stipulates that public interest corporations shall be legal persons, either as incorporated foundations or incorporated associations, with the purpose of conducting activities concerning the aid or payment of school expenses, scholarships or research expenses, sciences and charities in order to contribute to the general interest of society. The Act establishes various measures for public interest corporations to maintain their original goal of advancing public interest and to continue their activities successfully by preventing the abuse of the legal person system as a vehicle for other purposes under the pretense of public businesses<sup>5</sup>.

#### **4) Incorporated Associations and Incorporated Foundations**

The Civil Act divides non-profit corporations into incorporated associations or incorporated foundations depending on whether they are comprised of an association or foundation. Incorporated associations are legal persons formed based on an association or a group of people who join together for a given purpose, while incorporated foundations are established based on the entity of a foundation or property dedicated to a given purpose.

As incorporated associations are subject to the legal principle of collective autonomy as part of private autonomy, in addition to freedom of the collective decision-making, they may determine internal legal arrangements in an autonomous manner.

In addition, the courts set the legal precedent that the internal regulations of the organization, which sets the procedure, methods, and content of business or activities carried out to achieve the purpose of its establishment, shall not be null and void unless there are special circumstances such as the significant loss of validity in terms of social conventions including the violation of good morals and other aspects of social order (Supreme Court Decision 2008Da85345 Decided on October 15, 2009).

On the other hand, incorporated foundations are fundamentally different in that they are strongly constrained by the will of the founder<sup>6</sup>.

#### **5) Partnership Companies, Limited Partnership Companies, Limited Liability Companies, Stock Companies, and Limited Companies**

##### **A) Partnership Companies**

A partnership company solely consists of partners with direct and joint unlimited liability to the company's creditors (Article 212 of the Commercial Act). In return for bearing heavy responsibility to the company's creditors, each member has the right to manage corporate affairs and represent the company (Articles 200 and 207 of the Commercial Act). The consent of all members shall be required in order to decide the basic matters of the company (Articles 204, 227 (2) and 230 of the Commercial Act). No member shall, without the consent of all

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<sup>5</sup> Gwag Yun Jig and Kim Jae Hyung, *General Provisions of the Civil Act [Lecture on the Civil Act I]*, p. 161.

<sup>6</sup> Gwag Yun Jig and Kim Jae Hyung, *General Provisions the Civil Act [Lecture on the Civil Act I]*, p. 161; Jee Won-Lim, *Lecture on the Civil Act*, 14th edition, p. 103.

other members, transfer his/her status (equity interest) to other persons, but any member may withdraw from the company (Articles 197, 217 and 218 of the Commercial Act). Therefore, a partnership company is a suitable company structure for a small number of people to jointly operate and manage businesses based on strong mutual trust<sup>7</sup>.

## **B) Limited Partnership Companies**

A limited partnership company is a dual-structure firm composed of general partners, whose liability is the same as that of members of a partnership company, and limited partners, who bear direct and joint liability to creditors but only limited to the amount of their investment (Articles 268 and 279 of the Commercial Act). General partners contribute funds and also have the right to manage corporate affairs and represent the company (Articles 273 and 279 of the Commercial Act), while limited partners only commit capital, share profits, and are given supervisory authority since they cannot participate in business operations (Article 277 of the Commercial Act). However, basic decisions regarding corporate management require the consent of all members (Articles 269, 204, 227 (2) and 230 of the Commercial Act). Transfer of equity interest by limited partners requires the consent of all general partners, but not other limited partners (Article 276 of the Commercial Act), while general partners require the consent of all members in order to transfer their equity interest (Articles 269 and 197 of the Commercial Act). A limited partnership company is a type of company where limited partners provide capital to a business operated by general partners and participate in distributing the generated dividends. The Commercial Act considers a limited partnership company to be a modified form of a partnership company. Therefore, unless otherwise provided, provisions governing partnership companies shall apply *mutatis mutandis* to limited partnership companies (Article 269 of the Commercial Act)<sup>8</sup>.

## **C) Limited Liability Companies**

A limited liability company, a new type of company introduced with the revision of the Commercial Act in 2011, is similar to a limited company in that it is solely comprised of limited partners who are not directly liable to creditors but only liable for the partnership's debts to the extent of their investment (Article 287-7 of the Commercial Act), and in that it has legal personhood. However, it is different from a limited company in that members can execute corporate affairs independently without a third-party manager, such as a director (Article 287-12 of the Commercial Act), and in that a limited liability company internally contains the essence of an association. Thus, its corporate structure adopts the advantages that its members are able to internally and freely execute affairs, while externally bearing only limited liability. Therefore, a limited liability company is a suitable company structure for a joint enterprise of specialized professions, such as law firms, medical corporations and accounting firms<sup>9</sup>.

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<sup>7</sup> Chung Dong-Yoon, *Annotated Commercial Act*, Korea Judiciary Administrative Publishers Ltd., Part of Article 170.

<sup>8</sup> Chung Dong-Yoon, *Annotated Commercial Act*, Korea Judiciary Administrative Publishers Ltd., Part of Article 170.

<sup>9</sup> Chung Dong-Yoon, *Annotated Commercial Act*, Korea Judiciary Administrative Publishers Ltd., Part of Article 170.

## D) Stock Companies

The Commercial Act does not specifically define a stock company, but it is generally defined as “a company that owns a certain amount of capital invested by employees, the status of its employees is represented in the form of subdivided shares, and employees are liable only for the investment in the company to the extent of the subscription price that they paid for their shares and do not bear any direct responsibility for the company’s creditors<sup>10</sup>.”

A stock company is a business enterprise consisting of employees who do not bear any direct responsibility for creditors of the company but have an obligation to invest in the company to the extent of the value that they have paid to undertake shares (Article 331 of the Commercial Act), namely a company solely consisting of stockholders. When stockholders’ obligation is only limited to invest in the company, it is referred to limited stockholder liability. In response to the limited stockholder liability, stockholders participate in decision-making on basic matters by exercising their voting rights at a general meeting of stockholders, but they do not participate in executing business affairs. Instead, they delegate the execution of business affairs to the board of directors and the chief executive officer. In this regard, the phenomenon whereby stockholders are not involved in the company’s management despite being considered to be the owners of the company and instead entrust it to a third party is referred to as the separation of ownership and management.

On the other hand, stockholders can either appoint auditors at a general meeting of stockholders or designate members of the audit committee through the board of directors to supervise business affairs (Article 409 of the Commercial Act) and simultaneously exercise the right to supervise and rectify on their own accord without convening a general meeting of stockholders (Articles 402, 403, and 467 of the Commercial Act). In addition, the status of stockholders is represented in the form of stocks, which comprise equal proportional units that can be transferred freely (Article 335 (1) of the Commercial Act). As a stock company is not expected to form a fiduciary relation between stockholders, the association of many persons is possible, and therefore, it is a suitable company structure for operating a large-scale enterprise by collecting public capital<sup>11</sup>.

## E) Limited Companies

A limited company refers to the type of business whose members bear limited liability for their contribution to the company and no direct responsibility concerning the company’s creditors (Article 553 of the Commercial Act). The basic structure of a limited company is similar to that of a stock company, as each member of the company equally contributes to the company’s capital and is liable only for their contribution without bearing any direct responsibility regarding the company’s creditors<sup>12</sup>.

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<sup>10</sup> Song, Ok-ryeol, *A Lecture on the Commercial Act*, 4th edition, p. 721.

<sup>11</sup> Chung Dong-Yoon, *Annotated Commercial Act*, Korea Judiciary Administrative Publishers Ltd., Part of Article 170.

<sup>12</sup> Song, Ok-ryeol, *A Lecture on the Commercial Act*, 4th edition, p. 1231.

However, limited companies are distinguished from stock companies in that (i) a limited company’s members bear a heavier responsibility compared to a shareholder’s since they are, under special circumstances, liable to pay the amount of the shortfall to the company (Articles 550 and 593 of the Commercial Act) and the transfer of their equity is limited in consideration of the heavier responsibility (Article 556 of the Commercial Act), and that (ii) it is a suitable corporate structure for small exclusive companies as it is easy to establish and its organizational structure is relatively simplified.

In addition, a limited company’s organization is relatively simple and its establishment is streamlined, since the board of directors and the representative director are not separate (Articles 562 and 564 of the Commercial Act), and audits are optional (Article 568 of the Commercial Act). Therefore, it is a suitable corporate structure for small or medium-sized businesses because a limited company’s organizational structure is simpler than that of a stock company while the members bear the same responsibility as the shareholders<sup>13</sup>.

### C. Status of Legal Persons

#### 1) Status of Legal Persons in Korea

As of the end of 2017, there are a total of 769,684 corporations in Korea according to the number of corporations operating by region, which is publicly released on the website of the Korean Statistical Information Service (KOSIS) under Statistics Korea. Meanwhile, they can be divided into domestic (for-profit or non-profit) and overseas corporations based on address or legal basis for establishment. The table below outlines the status of legal persons by type of corporation, which is classified based on the above-mentioned criteria<sup>14</sup>.

[Status of Legal Persons in Korea<sup>15</sup>]

				(Unit: No.)
<b>Classifica</b>	<b>Domestic</b>	<b>For-profit<sup>16</sup></b>	<b>Partnership Companies</b>	939

<sup>13</sup> Chung Dong-Yoon, *Annotated Commercial Act*, Korea Judiciary Administrative Publishers Ltd., Part of Article 170

<sup>14</sup> In addition, legal persons can be classified into listed or unlisted ones, depending on whether they are listed on the stock exchange. Listed corporations must comply with the “corporate information disclosure system,” which requires the complete release of key corporate data that may significantly affect share prices, such as business performance, financial condition, merger or capital increase, with the aim of helping investors to accurately assess the current status of a corporation and to make free and informed investment decisions based on their own judgment and responsibility. (<http://regulation.krx.co.kr/contents/RGL/02/020101/RGL02010101.jsp>)

<sup>15</sup> KOSIS > Finance/Banking/Insurance > Finance > National Tax Statistics > National Tax Statistics (to recent) > Corporation Tax > Number of Legal Persons > “8.6.1 Number of Operating Legal Persons by Region” ([http://kosis.kr/?orgId=133&tblId=TX\\_13301\\_A105&vw\\_cd=MT\\_ZTITLE&list\\_id=133\\_13301\\_200\\_80\\_60&seqN](http://kosis.kr/?orgId=133&tblId=TX_13301_A105&vw_cd=MT_ZTITLE&list_id=133_13301_200_80_60&seqN))

<sup>16</sup> According to the national statistics portal site, KOSIS, the current status of limited liability companies is not surveyed separately from for-profit corporations. Taking into consideration the structure of limited liability companies, they are deemed to be included in the category of “limited companies.”

<b>tion according to address or legal basis for establishment</b>			<b>Limited Partnership Companies</b>	3,731
			<b>Stock Companies</b>	690,241
			<b>Limited Companies</b>	33,645
		<b>Non-profit</b>	<b>Incorporated Associations</b>	39,226
			<b>Incorporated Foundations</b>	
<b>Overseas</b>	1,902			

### **III. Risk for the Misuse of Legal Persons, Trusts, etc. for Money Laundering and Terrorist Financing**

(**Summary**) South Korea is relatively well-equipped with relevant laws, regulations, and systems, and has no social custom and culture of exploiting legal persons and trusts as a means of concealing beneficial owners. This indicates that legal persons and trusts are not considered at high risk of abuse for money laundering and terrorist financing.

In addition, the fact that trust and company service providers are not actively operating in Korea indicates that there is no active misuse of legal persons or trusts for money laundering and terrorist financing.

However, there have been cases in which legal persons and trusts have been misused as a vehicle for tax evasion, concealment of offshore assets, and indirect loans by major shareholders. In addition, with the enactment of severe criminal penalties on the use of bank accounts under borrowed names for illegal purposes since 2015, it became difficult to conceal the name of beneficial owners using bank accounts under borrowed names, thus resulting in the growing possibility of legal persons and trusts being abused for money laundering.

#### **1. Cases of Abuse of Legal Persons and Trusts for Money Laundering**

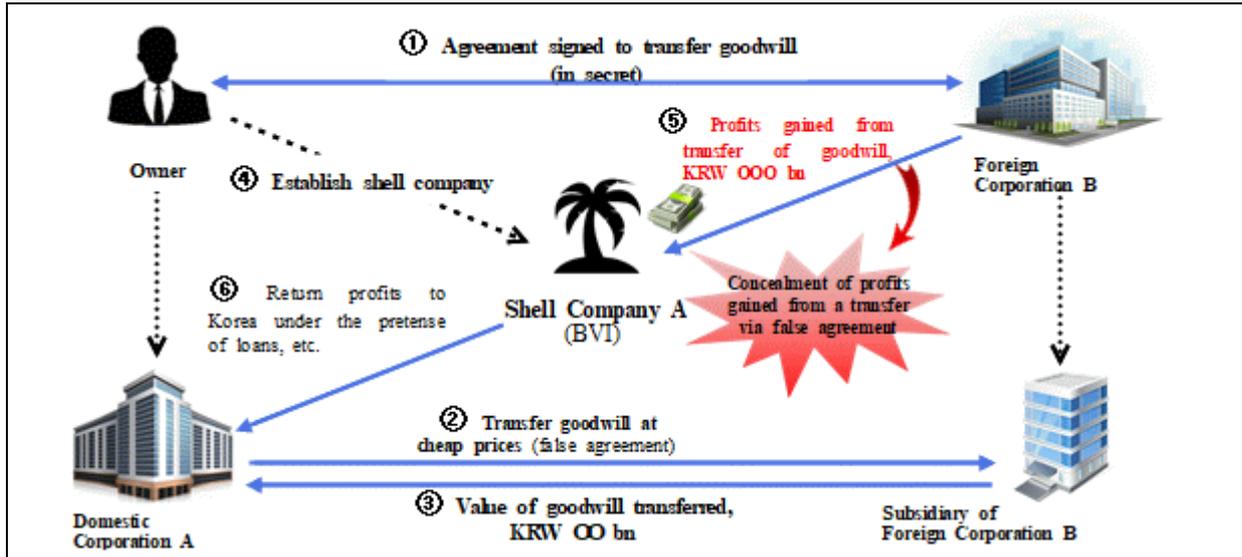
In order to prevent the various misuse and abuse of legal persons and trusts, the government agencies such as the National Tax Service, the Fair Trade Commission, and the Financial Services Commission have strived to take measures such as (i) tax audits of suspected offshore tax evaders; (ii) probes into the management condition of corporations; and (iii) formulation of systemic improvement plan. Such investigative activities identified various types of legal person abuse, with each case analyzed as follows.

##### **A. Tax Evasion (Transfer Tax, Income Tax, etc.) through the Establishment of Overseas Corporations**

The owner of Domestic Corporation A secretly agreed to transfer the goodwill held by the said domestic corporation to Foreign Corporation B and prepared a false agreement to fake the sale of the goodwill to a subsidiary of Foreign Corporation B at a cheap price with the aim to conceal the profits generated from the transfer. Then, upon filing the falsified report, the owner of the domestic corporation was paid the profits of the transfer from Foreign Corporation B in secret through Shell Company A, which was registered in the British Virgin Islands (hereinafter “BVI”), and returned the funds to Korea<sup>17</sup>.

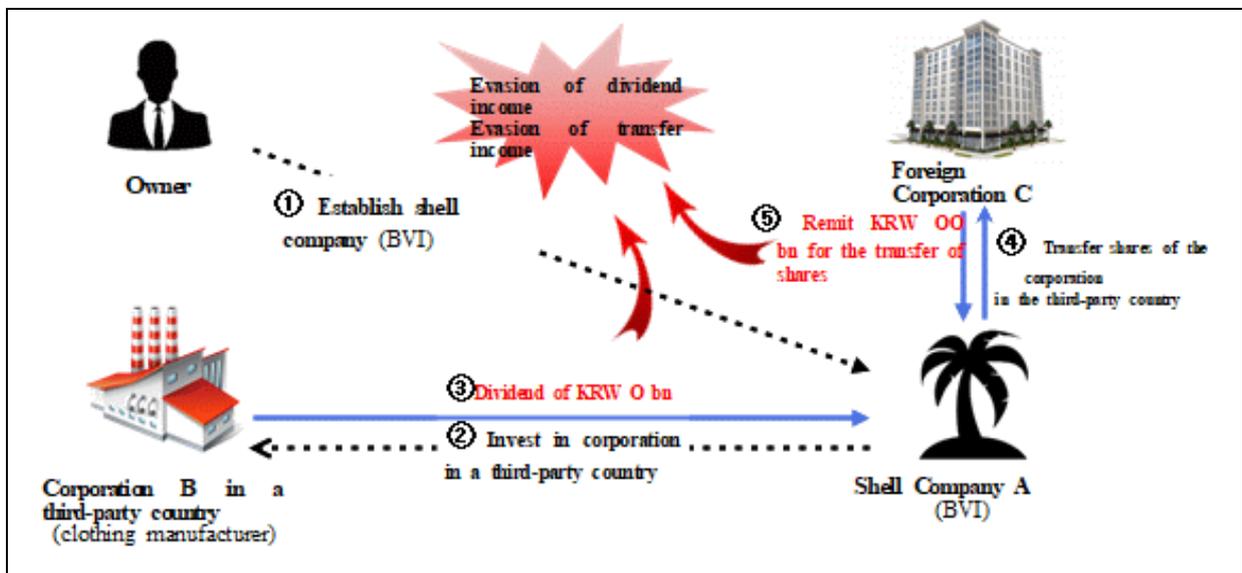
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<sup>17</sup> Press release of the National Tax Service, December 6, 2017, “National Tax Service Searches Thoroughly for Offshore Tax Evasion via Tax Havens for Taxation,” p. 7.



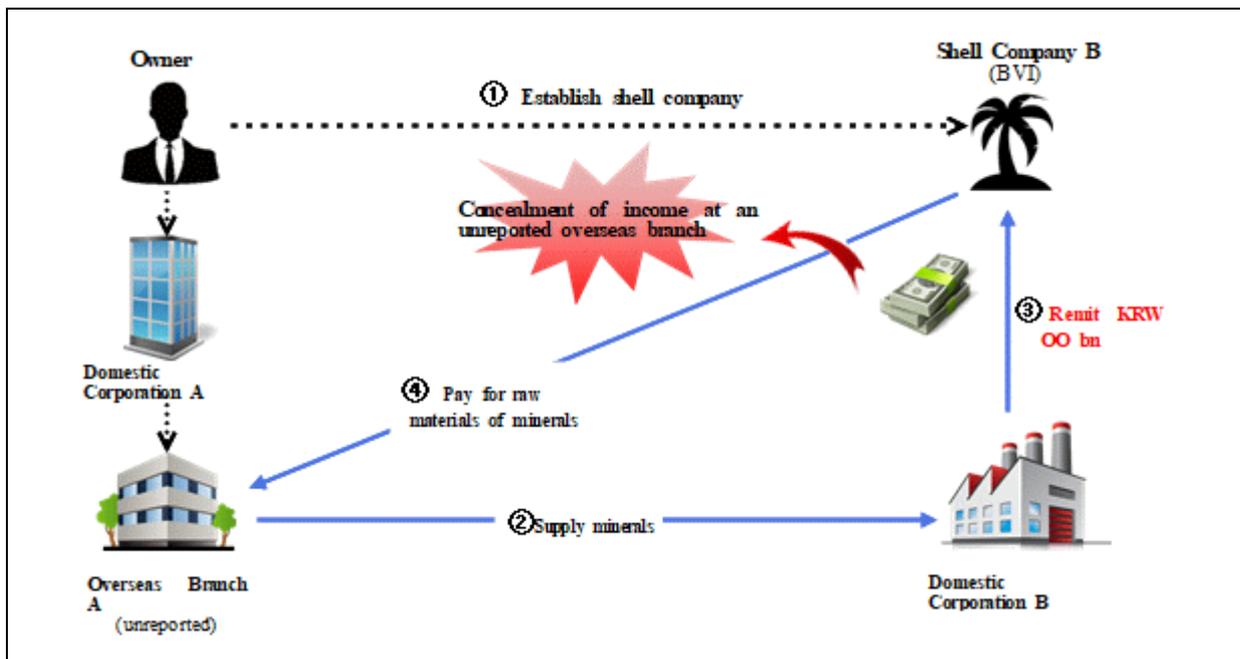
## B. Concealment of Assets Overseas through the Establishment of Overseas Corporations

(Capital flight under the pretense of foreign investment) A company owner invested in Corporation B (clothing manufacturer) located in a third-party country through Shell Company A, which was registered in BVI, and then sold the invested corporation in the third-party country to Foreign Corporation C. Then, the owner concealed the proceeds from the sale of the invested corporation in the third-party country by receiving the payment of the proceeds via an unreported account held under the name of Shell Company A<sup>18</sup>.



<sup>18</sup> Press release of the National Tax Service, December 6, 2017, "National Tax Service Searches Thoroughly for Offshore Tax Evasion via Tax Havens for Taxation," p. 8.

**(Expedient transactions with overseas local corporations)** The owner of Domestic Corporation A established Overseas Branch A of the corporation in order to import overseas resources and supply them in Korea, but did not report the overseas direct investment, etc. While supplying minerals to Domestic Corporation B through Overseas Branch A, the owner received payment for the supply via an account held under the name of Shell Company B established by the owner in a tax haven, concealed the payment overseas, and appropriated it for private use<sup>19</sup>.



**(Concealment of dividend income under a dual contract for preemptive rights)** Domestic Corporation A acquired preemptive rights under a dual contract in exchange for lending funds to Foreign Corporation A. However, the owner of Domestic Corporation A did not report its acquisition of preemptive rights to the regulatory authorities and transferred them to Shell Company B registered in Hong Kong without charge. When Foreign Corporation A paid out dividends, the owner received the dividends through Shell Company B and concealed them overseas<sup>20</sup>.

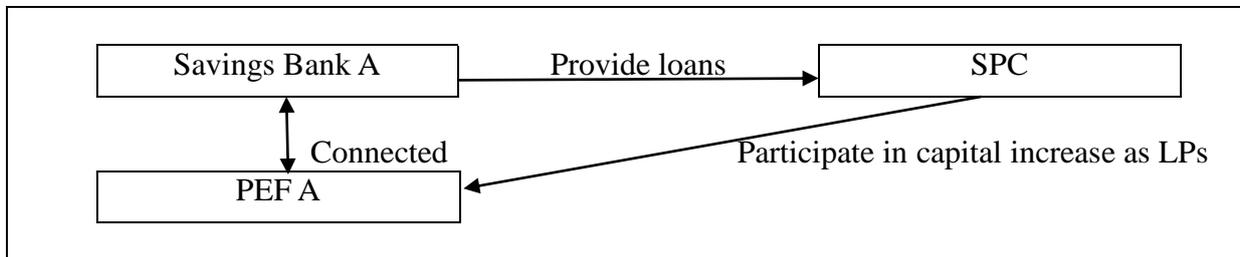
<sup>19</sup> Press release of the National Tax Service, December 6, 2017, “National Tax Service Searches Thoroughly for Offshore Tax Evasion via Tax Havens for Taxation,” p. 9.

<sup>20</sup> Press release of the National Tax Service, December 6, 2017, “National Tax Service Searches Thoroughly for Offshore Tax Evasion via Tax Havens for Taxation,” p. 11.



### C. Indirect Loans by the Majority Shareholder through the Establishment of Corporations

Savings Bank A provided loans of KRW 50 billion to three special purpose companies (hereinafter “SPCs”) acting as shell companies. However, contrary to the original purpose of the loans, these SPCs participated in the capital increase of Private Equity Fund (hereinafter “PEF”) A as limited partners (hereinafter “LPs”), which constituted indirect loans for the purpose of distorting financial health<sup>21</sup>.



### D. Evasion of Taxes (Transfer Tax, Income Tax, etc.) through the Establishment of Domestic Corporations

**(Exploitation of public interest corporations)** The results of the investigation conducted by the Fair Trade Commission in 2018 showed that a significant number of founding family members of large business groups have established public interest corporations to receive tax benefits and subsequently allowed such public interest corporations to hold a large amount of shares in major companies within their group or companies invested by second-generation members of their group’s founding family. Meanwhile, the investigation found that the proportion of stocks in the asset portfolio of the above-mentioned public interest corporations

<sup>21</sup> Press release of the Financial Services Commission, September 13, 2012, “Additional Measures to Improve System for Sound Management of Savings Banks,” p. 13.

reached 21.8 percent (stocks of affiliates accounted for 16.2 percent), which is four times higher than that of all public interest corporations, but their contribution to revenues reached only 1.15 percent (stocks of affiliates accounted for 1.06 percent). The investigation also confirmed that some public interest corporations were engaged in transactions of stocks, real estate, products, and services involving founding family members or affiliates<sup>22</sup>.

**<Current Status of Public Interest Corporations Engaging in Insider Trading>**

(As of 2016, Unit: No., %)

Classification	No. of Public Interest Corporations	Public Interest Corporations Engaging in Insider Trading	Frequency for Each Intra-Group Trading Type			
			Capital Transactions	Security Transactions including Stocks	Asset Transactions including Real Estate	Product/Service Transactions
Total business groups disclosed	165	100	1	10	36	92
Business groups subject to mutual equity investment limit	115	74	1	9	28	70
Other business groups disclosed	50	26	0	1	8	22

**(Trading of listed stocks using bank accounts under borrowed names)** Chairman A of Group A held stocks of the group’s affiliates under the name of 45 employees of the group for a period of decades to decentralize his stakes in the affiliates. As the prices of shares increased in recent years, the chairman sold his shares in affiliates including Company B and Company C that he held under the names of employees by using 98 bank accounts under borrowed names. Despite high capital gains through the stock sale, however, he avoided taxes as he did not file a capital gain tax return<sup>23</sup>.

<sup>22</sup> Press release of the Fair Trade Commission, July 2, 2018, “Analysis Results of Actual Operation Status of Public Interest Corporations Affiliated with Large Business Groups,” p.1 and p. 9.

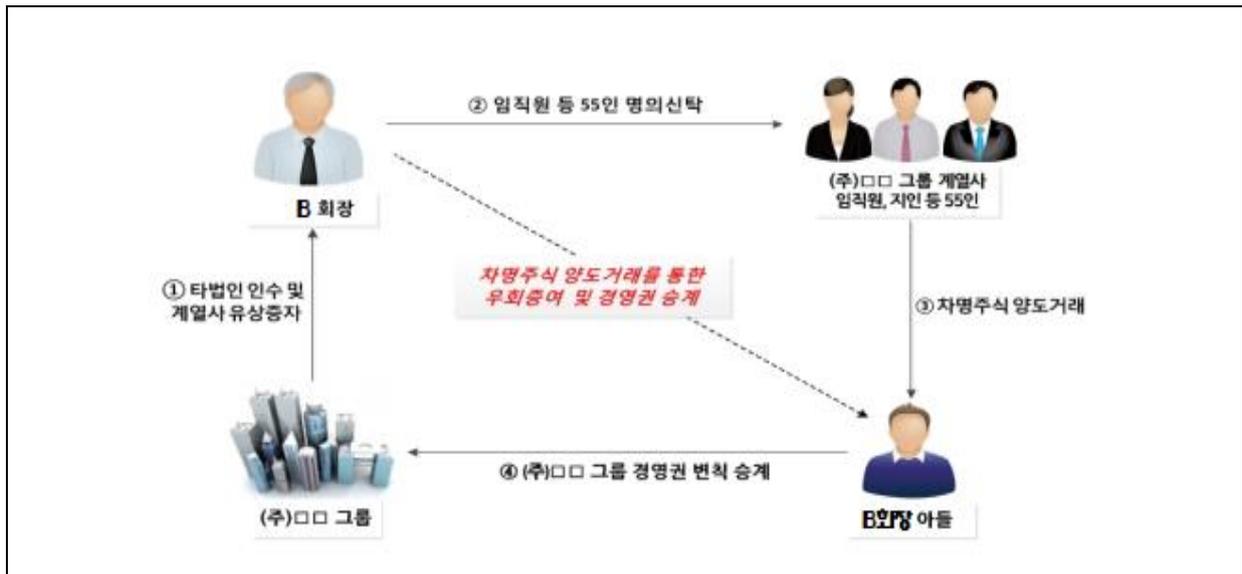
<sup>23</sup> Press release of the National Tax Service, October 18, 2016, “Actively Promote Normalization of Stock Ownership in Another Person’s Name through Integrated Analysis System for Borrowed-name Stocks,” p. 6.



- (주)□□그룹 A 회장  
Chairman A of Group A
- 임직원 명의로 (주)□□그룹 계열사 주식 명의 신탁  
Own shares in affiliates of Group A under the names of employees
- 임직원 1 (주)○○  
Employee 1 at Company B
- 임직원 2 ○○(주)  
Employee 2 at Company C
- 임직원 3 (주)○○건설  
Employee 3 at Construction Company D
- 임직원 4 ○○보험(주)  
Employee 4 at Insurance Company E
- 임직원 5 (주)○○  
Employee 5 at Company F
- 주식처분  
Dispose shares
- 양도세, 증여세 등 탈루  
Evasion of capital gain tax, gift tax, etc.
- 세금추징 검찰고발  
Tax collection
- Report to prosecution

**(Expedient succession of management rights)** In the process of taking over another corporation or raising capital by selling new shares, Chairman B of Group A acquired shares of 15 corporations in the group under the names of 55 persons including employees of affiliates, relatives, and representatives of business clients. Chairman B returned the ownership of some shares under other people’s names to himself by pretending that the said shares were transferred voluntarily to him. As for the remaining shares, he expediently succeeded management rights through an indirect contribution by pretending that the shares were acquired by his children<sup>24</sup>.

<sup>24</sup> Press release of the National Tax Service, October 18, 2016, “Actively Promote Normalization of Stock  
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차명주식 양도거래를 통한 우회증여 및 경영권 승계

Indirect contribution and succession of management rights through the transfer of stocks under borrowed names

B 회장

Chairman B

(주)○○그룹

Group A

(주)○○그룹 계열사 임직원, 지인 등 55인

55 persons including employees of Group A's affiliates and acquaintances

B 회장 아들

Chairman B's son

① 타법인 인수 및 계열사 유상증자

① Acquisition of other corporation and capital increase by selling new shares of affiliates

② 임직원 등 55인 명의신탁

② Acquire shares under the names of 55 employees

③ 차명주식 양도거래

③ Transfer of borrowed-name shares

④ (주)○○그룹 경영권 변칙 승계

④ Illicit succession of management rights of Group A

## E. Risk for the Misuse of Trusts, etc. for Money Laundering

In the case of Korea, it has been confirmed that there are almost no data (press release, etc.) on the illegal misuse of (business) trusts, (personal) trusts or special types of trusts under the Act on Capital Market and Financing Investment Business. However, under the current Trust Act, there are concerns that a trustor may make unenforceable tax claims by creating trusts and devolving assets that are subject to enforcement on trusts with the aim of evading

the relevant tax claims. Accordingly, there appears to be a possibility that the trustor may exploit trusts for the purpose of evading tax claims<sup>25</sup>.

There are occasionally overseas cases for the misuse of legal persons or trusts: establishment of multi-jurisdictional structures of legal persons and trusts to facilitate the movement and laundering of criminal funds; involvement of financial professionals in enhancing the effective concealment of beneficial ownership on legal persons, etc.; and employment of nominees to hide the identity of beneficial owners or trust and company service providers to establish shell companies more systematically<sup>26</sup>. However, such cases have been rarely found in Korea to date.

## 2. Cases of Misuse for Terrorist Financing and Risk Assessment of Korea

Meanwhile, with regard to terrorist financing, there are mainly overseas cases in which the accounts of non-profit organizations (Russia)<sup>27</sup> or legal persons that are rarely expected to make international wire transfers (e.g. telephone card distributors, food suppliers, etc.) are used to exploit legal persons, trusts, etc. (Europe)<sup>28</sup>. However, since Korea generally faces a relatively lower impact of terrorism than other countries<sup>29</sup> and has properly established regulations to prevent the occurrences of the aforementioned problems, such as the enforcement of the Act on Real Name Financial Transactions and Guarantee of Secrecy (“**Real Name Financial Transactions Act**”). Accordingly, it is deemed that there is insignificant need for concern about terrorist financing in Korea.

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<sup>25</sup> Lee Jeon-oh, “A Study on the Problem and Reform Measures of Trust Tax System,” *Sungkyunkwan Law*, vol. 25, no. 4, Sungkyunkwan University, December 2013. p. 527.

<sup>26</sup> The Misuse of Corporate Vehicles, including Trust and Company Service Providers, FATF/OECD, 2006, pp. 3-6.

<sup>27</sup> Korea Institute for International Economic Policy, *Compilation of Cases of Money Laundering related to Foreign Exchange and Capital Market*, 2012, p. 196.

<sup>28</sup> Ibid, p. 146.

<sup>29</sup> In the Global Terrorism Index 2016 released by the Institute for Economics and Peace, South Korea was classified into the group the least affected by terrorism (tied for 112th out of 163 countries in total).

<Global Terrorism Index 2016, p. 10>



RANK	COUNTRY	SCORE
77	Venezuela	1.998
78	Macedonia	1.86
79	Djibouti	1.78
80	Brazil	1.74
81	Madagascar	1.671
82	Bulgaria	1.631
83	Dominican Republic	1.562
84	Kyrgyzstan	1.445
85	Guinea	1.403
86	Belarus	1.357
87	Georgia	1.257
88	Belgium	1.245
89	Spain	1.203
90	Guatemala	1.144
90	Honduras	1.144
92	Albania	1.103
92	Estonia	1.103
94	Kazakhstan	0.934
95	Morocco	0.892
95	Lesotho	0.892
97	Netherlands	0.864
98	Ecuador	0.793
99	Laos	0.695
100	Eritrea	0.534
101	Argentina	0.499
101	Trinidad and Tobago	0.499
103	United Arab Emirates	0.422
104	Zimbabwe	0.413
105	Congo	0.365
106	Azerbaijan	0.346
106	Ghana	0.346
108	Switzerland	0.288
108	Armenia	0.288
110	Iceland	0.25
110	Liberia	0.25
112	Hungary	0.23
112	New Zealand	0.23
112	South Korea	0.23
112	Qatar	0.23
116	Austria	0.182
117	Montenegro	0.154
117	Uzbekistan	0.154
119	Bhutan	0.115
119	Jamaica	0.115

## **IV. Responses to the Risk for the Misuse of Legal Persons, Trusts, etc. for Money Laundering and Terrorist Financing**

Korea has a relatively well-established system to prevent legal persons, trusts, etc. from being misused for money laundering or terrorist financing. It has also continuously strengthened mechanisms for transparency with the aim of ensuring transparent in taxation. Relevant government agencies such as the National Tax Service, the Fair Trade Commission, and the Financial Services Commission have made various efforts to prevent legal persons, trusts, etc. from insolvency or misuse: (i) tax audits of suspected offshore tax evaders; (ii) probes into the management condition of corporations; and (iii) formulation of systemic improvement plan. Such efforts are considered to have further mitigated the risks of exploitation.

### **1. Legal Persons**

#### **A. Abolition of the Bearer Share System**

A bearer share refers to a share whose owner's name is not recorded in a share certificate or a register of shareholders, and entitles the owner of a share certificate to be recognized as the rightful shareholder. The bearer share system was introduced in 1963 with the enactment of the Commercial Act, but it triggered various problems as follows: i) it failed to contribute to capital increase by companies as there were no cases of the issuance of bearer shares; ii) concerns arose over the occurrence of blind spots in taxation including the avoidance of transfer tax caused by the difficulty in identifying owners; and iii) the system resulted in undermining the country's international credibility due to the lack of transparency in taxation and ownership structure of companies. Accordingly, as it was deemed that there was no practical value in maintaining the system, it was abolished on May 20, 2014 with the amendment of the Commercial Act. Currently, the country has established the foundation for enhancing the transparency of taxation and the ownership structure of companies by consolidating all shares as registered shares. This has made it possible to prevent the misuse of bearer shares or the right to purchase thereof, which was one of the primary concerns of the Financial Action Task Force (hereinafter "FATF")<sup>30</sup>.

#### **B. Trends of Dematerialization**

Dematerialization refers to the system that allows a company to transfer or pledge shares and exercise all rights associated with registered shares without holding physical share certificates by registering shares with the electronic registration ledger of an electronic registration authority as prescribed by the articles of incorporation, instead of issuing physical share certificates (Paragraphs (1) through (4) of Article 356-2 of the Commercial Act).

The Commercial Act stipulates that, in addition to shares, preemptive rights of holders of preemptive rights and holders of bonds with warrants (Article 420 (4) and Article 516 (7) of

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<sup>30</sup> Reasons for enactment and amendment of the Commercial Act (Law No. 12591, May 20, 2014, partial amendment)

the Commercial Act) and bonds of bondholders (Article 478 (3) of the Commercial Act) may be registered in the electronic registration ledger. Meanwhile, the act also provides that claims for payments, claims for the transfer of goods or securities, or securities indicating the status of employees may also be registered in the electronic registration ledger (Article 65 (2) of the Commercial Act).

With the introduction of the electronic registration system for shares, it has become unnecessary to issue physical securities. In this regard, companies enjoy actual benefits such as saving costs for fund raising, reducing the burden for shareholders to handle management tasks, and simplifying the procedures for issuing shares, while shareholders have the advantage of being easily able to exercise their rights without any concern over forgery or loss of shares.

Furthermore, the electronic registration system enables government agencies to more accurately and quickly identify securities information in the primary market and the secondary market. In this regard, the system not only plays a positive role in preemptively reducing the risk of money laundering arising from the anonymity of shareholders, but also provides the framework for introducing the electronic securities system, which will be discussed later.

### **C. Sharing of Taxation Information**

#### **Corporate Tax Act**

##### **Article 3 (Person with Tax Liability)**

(1) The following corporations are liable to pay corporate tax on any income pursuant to this Act:

1. A domestic corporation

#### **Framework Act on National Taxes**

##### **Article 81-13 (Confidentiality)**

(1) A tax official shall neither offer or disclose to others data that a taxpayer has submitted in order to fulfill his/her liability to taxation prescribed by tax-related Acts, or data that the tax official has obtained for the purpose of taxation or collection of national tax, etc. in discharging his/her duties (hereinafter, "taxation information"), nor make use of it except for the prescribed purposes: Provided, That in cases falling under any of the following subparagraphs, the tax official may offer the taxation information of taxpayers, insofar as it is appropriate for the purpose of use:

1. Where a local government, etc. requests taxation information in order to use for taxation or collection of the taxes prescribed by Acts;
2. Where governmental authorities request taxation information to use for tax action or the prosecution of a tax evader;
3. Where taxation information is requested by the submission order of a court or a warrant issued by a judge;

4. Where taxation information is requested by another tax official as it is necessary for taxation and collection of the national tax, or for placing questions or the investigation;
5. Where the Commissioner of the Korea National Statistical Office requests taxation information for compiling national statistics;
6. Where an agency established for the operation of a social insurance system under subparagraph 2 of Article 3 of the Framework Act on Social Security requests taxation information to perform business activities assigned to the agency under applicable Acts;
7. Where a State administrative agency, local government, or public institution under the Act on the Management of Public Institutions requests taxation information necessary to investigate or examine qualifications of a candidate for the grant of benefits or subsidies with the consent of the relevant party;
8. Where the Investigating Committee pursuant to Article 3 of the Act on the Inspection and Investigation of State Administration requests the provision of taxation information to a closed meeting by the resolution of the Investigating Committee in order to attain the goals of the investigation of state administration;
9. When the taxation information is requested pursuant to the provisions of other Acts.

In the case of a domestic corporation that generates income, corporate tax shall be imposed on the income (Article 3 (1) 1 of the Corporate Tax Act) and thus the data submitted by a corporation to the National Tax Service or the data obtained by the National Tax Service from a corporation in the course of its business duties in order to impose or collect national taxes (hereinafter “**Taxation Information**”) may be used as highly useful data in implementing the system for anti-money laundering and counter-financing against terrorism (hereinafter “**AML/CFT**”).

The government has continued to add exceptions to the duty of confidentiality on taxation information (Subparagraphs 7 and 8 of Article 81 (13) of the Framework Act on National Taxes). Such government measures allow each institution to legally utilize taxation information, which has consequently aided the implementation of AML/CFT.

#### **D. Strengthening of Screening for Loans to SPCs**

In February 2015, the Korean government identified the perfunctory conduct of basic and essential verification procedures by savings banks when extending loans as a primary reason behind fraud and accidents related to accounts receivable loans. Then, it devised the “Second Savings Bank Credit Business Advancement Policy” to ensure that such verification procedures are carried out in practice. To this end, the government tightened the screening procedures on actual borrowers, lending limits thereof, and securitization-related risks for loans extended by savings banks to SPCs, thereby significantly reducing the possibility that SPCs are used in unlawful transactions<sup>31</sup>.

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<sup>31</sup> Press release of the Financial Supervisory Service, February 5, 2015, “Lay foundation for Advancement of Credit Business at Savings Banks,” p. 4.

**[Handling Accounts Receivable Loans<sup>32</sup>]**

<b>Classification</b>	<b>When Handling Fraudulent Loans</b>	<b>After Improvement</b>
Check loan application documents	<p>- Omit or perfunctorily conduct basic, essential verification procedures</p> <p>* Comparison of matters stated among loan application documents, adequacy of issuance of handwritten tax invoices, conformity between contracts and actual transactions, etc.</p>	<p>- Thoroughly carry out basic, essential verification procedures based on a checklist, etc.</p> <p>* Include detailed checks on the entire process of loan handling, including SPC collateral (accounts receivable) as well as loan application documents</p>
Check collateral (accounts receivable)	<p>- Verify the actual sales generated, the maintenance of relationships between companies engaged in transactions, etc. solely based on false documents submitted</p>	<p>- Check the existence of accounts receivable through field visit to buyers and suppliers</p> <p>- Tighten bond transfer and acquisition procedures</p> <p>· Notify multiple persons in charge at purchasing companies with regard to the transfer of bonds, if necessary</p>
Screen loans to SPCs (borrowers)	<p>- Loans to SPCs are only screened with a focus on the current status of SPCs. Screening on actual borrowers is insufficient.</p>	<p>- Strengthen the verification of SPCs (governance, affiliates, total credit, and purpose of establishment) and need for securitization</p>

**E. Mandatory Identification of Beneficial Owners of Legal Persons or Organizations Involved in Financial Transactions<sup>33</sup>**

<sup>32</sup> Press release of the Financial Supervisory Service, February 5, 2015, “Lay foundation for Advancement of Credit Business at Savings Banks,” p. 6.

<sup>33</sup> Reasons for the enactment and amendment of the Act on Reporting and Using Specified Financial Transaction Information (Law No. 12716, May 28, 2014, partial amendment) were reorganized and explained.

## Act on Reporting and Using Specified Financial Transaction Information

### Article 5-2 (Customer Due Diligence for Financial Companies, etc.)

(1) As part of due diligence to guard against the risk of money laundering and financing of terrorism using financial transactions, each financial company, etc. shall take the measures classified as follows. In such cases, any financial company, etc. shall prepare and implement work guidelines for such measures:

1. Where a customer opens an account or makes a single financial transaction of at least the amount prescribed by Presidential Decree: to verify any of the following items:

(a) Customer's personal information and others related thereto prescribed by Presidential Decree;

(b) A natural person finally governing and controlling a customer (hereafter, "actual owner" in this Article) and others related thereto: Provided, That, where a customer is a legal person or organization, matters prescribed by Presidential Decree;

2. Where it is likely for a customer to commit money laundering or financing of terrorism, including where it is doubt that the customer is the beneficial owner:

(a) Any item of subparagraph 1;

(b) Matters determined and publicly notified by the Commissioner of the Korea Financial Intelligence Unit including the purpose of financial transaction and the origin of funds for transaction (limiting to the scope rationally determined by financial company etc., that it is possible to verify, having regard to the risks of money laundering and financing of terrorism.

(2) Work guidelines under paragraph (1) shall include the details, procedures, and methods of appropriate measures related to the prevention of money laundering or financing of terrorism, by type of customer and financial transaction.

(3) The object, standards, procedures, and methods of verification measures, etc. under each subparagraph of paragraph (1) and other necessary matters shall be prescribed by Presidential Decree.

(4) Where it is not possible to verify identity of a customer because he/she refuses to provide information for identification, financial company, etc., shall reject a new transaction with the customer such as opening the new bank account, and if the customer has a transaction relation, the financial company shall terminate such transaction.

(5) Where a transaction is rejected or terminated under paragraph (4), financial company, etc., shall review whether to report a suspicious transaction under Article 4.

Meanwhile, according to **FATF** recommendations, the government has defined matters concerning the beneficial owners of customers as basic customer identification items and deemed the purpose of transactions, the source of funds, etc. as additional customer identification items, thereby preventing illegal transactions under borrowed names and striving to establish sound and transparent order in financial transactions.

In addition, according to the revised Act on Reporting and Using Specified Financial Transaction Information, if a financial institution, etc. deems it impossible to identify a

customer, it may reject a new transaction or terminate an existing transaction, thereby preventing the act of money laundering or funds for terrorism and avoiding the use of illegal funds for crimes (each subparagraph of paragraph (1), paragraph (4), and paragraph (5) of Article 5-2 of the Act on Reporting and Using Specified Financial Transaction Information).

## **F. Implementation of the Beneficial Owner Identification System for Stocks under Borrowed Names**

In the past, due to the provision that required more than three incorporators under the Commercial Act<sup>34</sup>, stocks were inevitably listed in another person's names when a corporation was established. As a result, some companies were unable to return under the names of beneficial owners due to the difficulty of proving their ownership after a long period or due to concerns over taxes. For such companies, the government has implemented the "Identification System of Beneficial Owners for Borrowed-name Stocks" since June 23, 2014, which enables companies to return under the beneficial owners of stocks in other people's names through simplified procedures using application documents and National Tax Service documents without undergoing complicated taxation verification procedures, even in cases where supporting documents are somewhat insufficient<sup>35</sup>.

The system has been assessed positively as it enables the identification of the beneficial owners of corporations through incentives rather than unilateral regulations.

## **G. Establishment of the Integrated Analysis System for Borrowed-name Stocks**

Stocks in nominal trust have been misused for not only large-scale tax evasion but also illegal transactions including the avoidance of dispositions for tax arrears and stock price manipulation. Accordingly, the government has established the "Integrated Analysis System for Borrowed-name Stocks" based on the information analysis function of the Neo Tax Integrated System (NTIS)<sup>36</sup>, a new national tax administration system, thereby focusing tax administration capacity on preventing tax evasion activities using nominal trust<sup>37</sup>.

## **H. Limit on the Exercise of Borrowed-name Shareholders' Rights**

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<sup>34</sup> The provision refers to the former Article 288 of the Commercial Act, which was later amended to law no. 6488 on July 4, 2001.

<sup>35</sup> Press release of the National Tax Service, June 18, 2014, "We will help to return stocks in other people's names held by small and medium-sized companies to beneficial owners through simplified procedures," p. 1.

<sup>36</sup> NTIS is a system that digitizes the entire process of national tax administration, encompassing guidance for national tax returns, receipt of tax statements, tax payment, and tax audits. It consists of Hometax, a comprehensive online service for the public that allows taxpayers to access the service via Internet and carry out various tasks such as electronic tax filing and information inquiry related to taxation and the tax administration portal for employees of the National Tax Service to conduct their duties (Press release of the National Tax Service, July 27, 2017, "NTIS (next-generation national tax administration system) marks its second anniversary and obtains ISO certification," p.2).

<sup>37</sup> Press release of the National Tax Service, October 18, 2016, "Actively Promote Normalization of Stock Ownership in Another Person's Name through Integrated Analysis System for Borrowed-name Stocks," p.1.

In the past, the Supreme Court found that nominal shareholders whose names are listed on the register of shareholders are recognized to be effectively able to establish the authority to exercise their shareholders' rights even without proving their actual rights to the company, but being registered on the register of shareholders does not imply recognition of the creative effect of their shareholders' right. Therefore, in cases where shareholders acquire shares under a borrowed name with consent and make payment for the shares, only the person who actually pays for the shares while using a borrowed name becomes the actual shareholder. Such decision actually allows shareholders under borrowed names to exercise shareholders' rights to the company<sup>38</sup>.

However, the Supreme Court recently changed its position from its previous stance by a full-bench ruling and found that, in cases where persons who intend to acquire or transfer shares of a company do so under borrowed names and list the names on the register of shareholders, it is deemed that, in terms of the relationship with the company, only the shareholders whose names are listed on the register of shareholders can legally exercise shareholders' rights, such as the right to vote<sup>39</sup>. Therefore, it is expected that shareholders under borrowed names can no longer control the company through shares, which indicates that actual shareholders have no option other than being listed on the register of shareholders.

## 2. Trusts

### A. Business Trusts

#### **Act on Capital Market and Financing Investment Business**

##### **Article 12 (Authorization for Financial Investment Business)**

(1) An entity that wishes to engage in financial investment business shall select all or any part of its business units defined by Presidential Decree (hereinafter, "authorized business unit"), by specifying the following constituents, and shall obtain authorization for each financial investment business from the Financial Services Commission.

1. The type of financial investment business (referring to investment trading business, investment brokerage business, collective investment business, and trust business, and also including underwriting business in the category of the investment trading business)

##### **Article 15 (Meeting with Requirements for Authorization)**

Each financial investment business entity shall continue to meet the requirements for authorization provided for in the subparagraphs of Article 12 (2) (excluding Article 12 (2) 6 (a) and 6-2, referring to the relaxed requirements prescribed by Presidential Decree in the case of subparagraph 12 (2) 2 and 6 (b)), while engaging in financial investment business with authorization granted under Article 12.

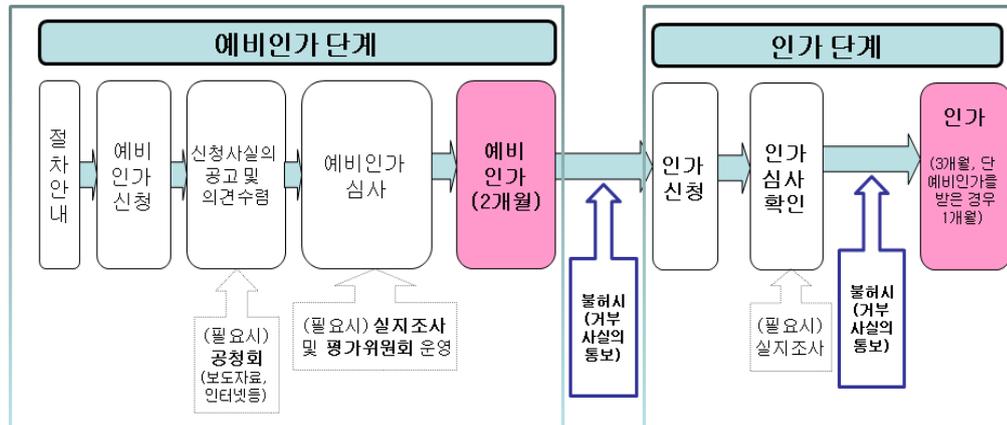
Whereas the government adopts a voluntary registration system for the financial

<sup>38</sup> Supreme Court Decision 2010Da22552 Decided on May 26, 2011 and others

<sup>39</sup> Supreme Court Decision 2015Da248342 Decided by a full-bench ruling on March 23, 2017

investment businesses that do not require customers to entrust their assets (discretionary investment business and investment advisory business), it requires business trust entities to obtain approval through preliminary and final authorization procedures (Article 12 (1), 14 (1) of the Act on Capital Market and Financing Investment Business) and to continue to meet the requirements after they obtain authorization (Article 15 of the Act).

[Flow Chart of the General Authorization Procedures<sup>40</sup>]



예비인가 단계	Preliminary Authorization Procedure
절차안내	Introduction to the procedure
예비인가 신청	Application for preliminary authorization
신청사실의 공고 및 의견수렴	Public disclosure of the application and collection of opinions
예비인가 심사	Deliberation for preliminary authorization
예비인가 (2개월)	Granting preliminary authorization (for two months)
(필요시) 공청회 (보도자료, 인터넷 등)	(If necessary) hosting a public hearing (press release, Internet, etc.)
(필요시) 실지조사 및 평가위원회 운영	(If necessary) conducting a physical investigation and an evaluation committee

불허시 (거부 사실의 통보)

Disapproval (notice of rejection)

인가 단계	Authorization Procedure
인가 신청	Application for authorization
인가 심사 확인	Confirmation of authorization deliberation
인가 (3개월, 단 예비인가를 받은 경우 1개월)	Granting authorization (for three months. If the entity obtained preliminary authorization, one month will be granted.)
(필요시) 실지 조사	(If necessary) physical investigation
불허시 (거부 사실의 통보)	Disapproval (notice of rejection)

However, the government fundamentally precludes the possibility of the misuse of trust by heightening the barriers of entry into the industry, by setting the minimum capital requirement for obtaining authorization for (business) trust at KRW 12 billion.

<sup>40</sup> Capital Market Supervision Department and Asset Management Supervision Department of the Financial Supervisory Service, "Financial Investment Business Authorization Manual," August 2018, p. 11.

[Authorization Business Unit and Minimum Equity<sup>41</sup>]

3-1-1	집합투자업	모든펀드		일반+전문	80 <sup>1)</sup>
3-11-1			증권펀드(MMF포함)	일반+전문	40 <sup>1)</sup>
3-12-1			부동산펀드	일반+전문	20 <sup>1)</sup>
3-13-1			특별자산펀드	일반+전문	20 <sup>1)</sup>
3-14-1	전문사모집합투자업	모든펀드		적격 <sup>2)</sup>	20
4-1-1	신탁업	모든신탁재산		일반+전문	250 <sup>3)</sup>
4-11-1			금전신탁	일반+전문	130 <sup>3)</sup>
4-12-1			금전제외신탁	일반+전문	120 <sup>3)</sup>
4-121-1			부동산신탁	일반+전문	100 <sup>3)</sup>
5-1-1	투자자문업	증권, 파생상품, 부동산, 예치금		일반+전문	8 <sup>1)</sup>
5-2-1			증권, 파생상품, 예치금	일반+전문	5 <sup>1)</sup>
5-3-1			부동산, 예치금	일반+전문	3 <sup>1)</sup>
6-1-1	투자일인업	증권, 파생상품, 부동산, 예치금		일반+전문	27 <sup>1)</sup>
6-2-1			증권, 파생상품, 예치금	일반+전문	15 <sup>1)</sup>
6-3-1			부동산, 예치금	일반+전문	12 <sup>1)</sup>

3-1-1	Collective investment business	All funds		General + specialized	80
3-11-1			Securities fund (including MMF)	General + specialized	40
3-12-1			Real estate fund	General + specialized	20
3-13-1			Special asset fund	General + specialized	20
3-14-1	Hedge fund investment business	All funds		Qualified	20
4-1-1	Trust business	All types of trust property		General + specialized	250
4-11-1			Money trust	General + specialized	130
4-12-1			Trust excluding money	General + specialized	120
4-121-1			Real estate trust	General + specialized	100
5-1-1	Investment advisory business	Securities, derivatives, real estate, and deposits		General + specialized	8
5-2-1			Securities, derivatives, and deposits	General + specialized	5
5-3-1			Real estate and deposits	General + specialized	3
6-1-1	Discretionary investment business	Securities, derivatives, real estate, and deposits		General + specialized	27
6-2-1			Securities, derivatives, and deposits	General + specialized	15
6-3-1			Real estate and	General + specialized	12

<sup>41</sup> Capital Market Supervision Department and Asset Management Supervision Department of Financial Supervisory Service, "Financial Investment Business Authorization Manual," August 2018, p. 22.

			deposits		
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**Act on Reporting and Using Specified Financial Transaction Information**

**Article 2 (Definitions) The terms used in this Act shall be defined as follows:**

1. The term “financial company, etc.” refers to each of the following persons:
  - (e) Investment traders, investment brokers, collective investment entities, trust entities, financial securities companies, merchant banks, transfer agency companies under the Act on Capital Market and Financing Investment Business.

**Article 4 (Reporting, etc. on Transactions of Suspected Illegal Assets, etc.)**

- (1) Any financial company, etc. shall report any of the following cases to the Commissioner of the Korea Financial Intelligence Unit, as prescribed by Presidential Decree without delay.

**Article 4-2 (Reporting of Large Cash Transactions by Financial Companies, etc.)**

- (1) Where a financial company, etc. has paid to, or received from the other party to a financial transaction, the amount or more prescribed by Presidential Decree to the extent not exceeding KRW 50 million in cash (excluding foreign currencies) or using other means of payment equivalent to cash prescribed by Presidential Decree (hereinafter “cash, etc.”), it shall report such fact to the Commissioner of the Korea Financial Intelligence Unit within 30 days.

However, authorized trust entities are included in financial institutions that are directly subject to AML/CFT Regulation (Article 2 (1) e, Article 4 (1), Article 4-2 (1), etc. of the Act on Reporting and Using Specified Financial Transaction Information). Considering all of the above, it is highly unlikely that a business trust will be involved in money laundering and terrorist financing.

**B. Personal Trusts**

**Trust Act**

**Article 8 (Fraudulent Trusts)**

- (1) If an obligor has created a trust knowing that it would be prejudicial to an obligee, the obligee may claim for the cancellation and reinstatement, as prescribed in Article 406 (1) of the Civil Act, against the trustee or beneficiary, even if the trustee has acted in good faith: Provided, That the same shall not apply where the beneficiary has not been aware of prejudicing the obligee as at the time he/she acquired the right to benefit.
- (2) In cases falling under the proviso to paragraph (1), where some beneficiaries have not been aware of prejudicing an obligee as at the time they acquired the right to benefit, the obligee may claim for the cancellation and reinstatement as prescribed in the main sentence of paragraph (1) only against the beneficiaries in bad faith.
- (3) In cases falling under the main sentence of paragraph (1), the obligee may claim for reinstatement against beneficiaries in good faith to the extent of existing trust property.

(4) Where a trust is canceled and the trust property is reinstated, the truster shall, with respect to the cancelled trust, be responsible to the third person in good faith who has conducted a transaction with the trustee of the relevant trust to the extent of the trust property so reinstated.

(5) An obligee may request a beneficiary in bad faith to transfer the right to benefit he/she has acquired to the truster. In such cases, Article 406 (2) of the Civil Act shall apply *mutatis mutandis*.

(6) A beneficiary or trustee who has colluded in a fraudulent trust or abetted or aided the truster in creating a fraudulent trust in cases falling under paragraph (1) shall, jointly and severally with the truster, be liable for the compensation for the loss suffered by the obligee therefrom.

Since a personal trust is rarely used in practice, there is almost no risk for it to be misused. However, as mentioned above, there are concerns over the possibility of evading tax claims even in the case of personal trusts. In response, the government has prepared provisions on fraudulent trusts as stipulated in the Trust Act (Article 8 of the Trust Act).

## V. Sanctions on Legal Persons, Trusts, etc.

### 1. Sanctions for Nominal Shareholders (or False Shareholders)

#### Corporate Tax Act

##### **Article 75-2 (Additional Tax on the Unconscientious Reporting of Detailed Statement of Changes in Stocks, Etc.)**

(2) Where a domestic corporation obligated to submit a detailed statement of changes in stocks, etc., pursuant to Article 119 (hereafter, “detailed statement” in this paragraph) falls under any of the following cases, the corporation shall pay an amount equivalent to 1/100 of the par value or investment value of the stocks, etc, in addition to the corporate tax.

1. Where it fails to submit the detailed statement;
2. Where it submits the detailed statement which omits changes in stocks, etc.;
3. Where the detailed statement submitted is found unclear with regard to the descriptions prescribed by Presidential Decree.

##### **Article 119 (Submission of Detailed Statement of Changes in Stocks, etc.)**

(1) A corporation (excluding a partnership corporation, etc. prescribed by Presidential Decree) whose stocks, etc. changes during a business year shall submit a detailed statement of changes in stocks, etc. to the head of the tax office having jurisdiction over the place of tax payment by the filing deadline specified in Article 60, as prescribed by Presidential Decree.

#### Enforcement Decree of the Corporate Tax Act

##### **Article 161 (Submission of Detailed Statement of Changes in Stocks, etc.)**

(6) The form of the detailed statement of changes in stocks, etc., referred to in Article 119 of the Act shall be stipulated by Ordinance of the Ministry of Strategy and Finance, and the following matters shall be entered on the detailed statement based on the real holders of stocks, etc.:

1. The names of stockholders, etc. or the corporation, and the resident registration numbers, the business registration numbers, or identification numbers;
2. The holding status of the stocks, etc., by stockholders, etc.;
3. Changes in stocks, etc., during the relevant business year.

The government has levied additional tax when matters stated in the detailed statement of changes in stocks, etc. differ from the entry concerning a change of ownership in the register of shareholders. Since the business year beginning on January 1, 2012, it has levied additional tax when details about the beneficial owners of stocks etc. are different from the content of the relevant statement (each subparagraph of Article 75-2 (2), Article 119 (1) of the Corporate Tax Act, and each subparagraph of Article 161 (6) of the Enforcement Decree of the Act), thereby effectively placing restrictions on the listing of nominal shareholders (or

false shareholders) on the register of shareholders.

## 2. Sanctions on False Publication and False Reporting

With regard to the reporting document on the large-scale ownership of stocks, etc. that are described in section **I.4. F** above, a person who makes a false statement or representation of a salient fact specified by Presidential Decree or omits to state or represent a salient fact in such documents shall be punished by imprisonment for not more than five years or by a fine not exceeding KRW 200 million (Article 444 (1) 18 of the Act on Capital Market and Financing Investment Business).

### **Article 153 (Reporting on Stocks, etc. Held in Bulk) of Enforcement Decree of the Act on Capital Market and Financing Investment Business**

(2) “Matters prescribed by Presidential Decree” in the former part of Article 147 (1) of the Act means any of the following:

1. Matters concerning the person (hereinafter, “holder of stocks in bulk”) who comes to hold stocks, etc. in bulk (referring to holding in bulk as provided for in Article 147 (1) of the Act) and his/her related persons;
2. Matters concerning the issuer (referring to an issuer prescribed in Article 148 of the Act) of the stocks, etc. held in bulk;
3. Grounds for such change;
4. The date, price, and method of acquisition or disposition;
5. The form of holding;
6. Details of procurement of funds necessary for acquisition or the goods subject to the exchange (including lenders, if the funds or the goods are borrowed);
7. Detailed matters prescribed and publicly notified by the Financial Services Commission in relation to the matters referred to in subparagraphs 1 through 6.

## 3. Sanctions on False Registration

### **Criminal Act**

#### **Article 228 (Untrue Entry in Officially Authenticated Original Deed)**

(1) Any person who makes a false report to a public official and has that official enter record any false fact in the authentic deed or identical special media records, such as electronic records, shall be punished by imprisonment for not more than five years or a fine not exceeding KRW 10 million.

#### **Article 229 (Uttering of Falsified Public Document, etc.)**

Any person who utters any document, drawing, special media records, such as electronic

records, original of the authentic deed, license, permit, registration certificate, or passport, which is made by the crime as prescribed in Articles 225 through 228, shall be punished by the penalty as prescribed against each crime.

**Ulsan District Court, Decision 2017No578, Decided on July 14, 2017**

The defendant falsified the registration of incorporation for the purpose of circulating bank accounts in the name of the corporation, opened several bank accounts in the name of the company and rented the means to access them. The nature and circumstance of the crime are severely reprehensible. The circumstances of the case are unfavorable to the defendant in that the means of accessing the circulated accounts are at the risk of being used for crimes such as voice phishing, and that the defendant committed the crime within a period of cumulative crimes. In addition, comprehensively considering every ground for sentencing as presented in this case, including the defendant's family background, age, characters and conducts, environment, and circumstance after committing the crime, the sentence of the original court is deemed to be reasonable and within the appropriate range with no concern of excessive severity.

However, the government regards the falsification of the registration of incorporation as a false entry into public electronic records, which is punishable by imprisonment for not more than five years or a fine not exceeding KRW 10 million (See Article 228 (1) and Article 229 of the Criminal Act and Ulsan District Court's Decision 2017No578 decided on July 14, 2017).

#### **4. Sub-conclusion**

Considering all the matters described above comprehensively, Korea has been faithfully making various efforts (i) to fulfill the recommendations required by the FATF including the abolition of the bearer share system, and (ii) to identify the beneficial owner of corporations. In addition, (iii) AML/CFT is naturally strengthened as a positive result of efforts to enhance the convenience of tax collection and tax administration and (iv) business trusts, which account for the majority of trust operations in Korea, are adequately regulated by financial supervisory agencies and the Act on Reporting and Using Specified Financial Transaction Information. As a result, the risk of money laundering and terrorist financing by both domestic legal persons and trusts are estimated to be exceedingly low.

## VI. Additional Countermeasures to Prevent the Misuse of Legal Persons, Trusts, etc. for Money Laundering and Terrorist Financing

The Korean government is striving to prepare various additional countermeasures to enhance the transparency of legal persons, trusts, etc. These countermeasures are expected to play an important role in preventing legal persons, trusts, etc. from being exploited for money laundering and terrorist financing. The details of the countermeasures are as follows.

### 1. Implementation for the Electronic Securities System

In cases where the shareholder's identity is kept confidential by principle, it is difficult to monitor changes in ownership and the potential for the relevant shareholder to misuse the corporation becomes significantly higher. To solve these problems, the government has endeavored to introduce the electronic securities system<sup>42</sup> as follows, beginning with the establishment of a taskforce dedicated to introducing electronic securities system in September 2014. After four years of preparation, the system is soon to be launched.

#### [Progress of the Project for Introducing Electronic Securities System]<sup>43</sup>

'14.9월	전자증권제도 도입 추진단(T/F) 구성·운영
'15.5월	전자증권제도 도입 방안 발표 및 법안 국회 제출
'15.6~10월	정부안 입법예고 및 관계 부처 의견 수렴
'16.2월	「주식·사채 등의 전자등록에 관한 법률」(안) 국회 정무위 통과
'16.3월	전자증권법안 국회 본회의 통과(3.3) 및 공포(3.22)
'16.8월	전자증권시스템 구축 전담T/F 구성
'17.1월	전자증권제도 도입 추진 기본계획 수립
'17.2월	시행령 제정을 위한 "전담협의회" 구성·운영
'17.6월	전자증권법 시행령 제정안 제출
'19.9월	전자증권법 시행 예정

<sup>42</sup> The electronic securities system does not issue securities in physical form. It enters information on the creation, modification, or lapse of the right to stocks, etc., such as types, issues, amount, and rights holder of stocks, etc., and details of rights, etc. in the electronic register. Trades of stocks and execution of rights to stocks are all conducted electronically. [Each subparagraph of Article 2 of the Act on Electronic Registration of Stocks, Bonds, Etc. (hereinafter "the Electronic Securities Act")]

<sup>43</sup> Introduction to the electronic securities system, January 11, 2019, <http://www.ksd.or.kr/static/KJ0101000000.home?menuNo=1184>, by Korea Securities Depository

September 2014	Establishment and operation of a taskforce for introducing the electronic securities system
May 2015	Announcement of the plan to introduce the electronic securities system and submission of the relevant bill to the National Assembly
June – October 2015	Pre-announcement of the government’s draft legislation and collection of opinions from relevant agencies
February 2016	The bill of “the Act on Electronic Registration of Stocks, Bonds, Etc.” passed in the National Policy Committee of the National Assembly
March 2016	The bill of the Act passed in the main session of the National Assembly (March 3) and published (March 22)
August 2016	Establishment of a dedicated taskforce for building the electronic securities system
January 2017	Establishment of a basic plan for introducing the electronic securities system
February 2017	Establishment and operation of a dedicated council for the formulation of the Enforcement Decree of the Act
June 2017	Submission of the bill for the Enforcement Decree of the Act
September 2019	Scheduled enforcement of the Act

As of September 11, 2019, the Electronic Securities Act will enter into effect and the electronic securities system will be launched in earnest, which requires listed stocks to be registered in the electronic securities system through electronic registry (each subparagraph of Article 25 (1) of the Electronic Securities Act).

**Act on Electronic Registration of Stocks, Bonds, Etc. [Enforcement date to be decided] [Act No. 14096, enacted on Mar. 22, 2016]**

**Article 25 (New Electronic Registration of Stocks, etc.)**

(1) Where an issuer intends to newly issue stocks, etc. by electronically registering them, or to have right holders possess or acquire stocks, etc. for which certificates, etc. are already issued, it may apply for new electronic registration of stocks, etc. to an electronic registry: Provided, That regarding any of the following stocks, etc., it shall apply for new electronic registration to an electronic registry:

1. Stocks, etc. listed on the securities market defined in Article 8-2 (4) 1 of the Act on Capital Market and Financing Investment Business;
2. Beneficial interests in an investment trust prescribed in the Act on Capital Market and Financing Investment Business or stocks of an investment company;
3. Other stocks, etc. prescribed by Presidential Decree as necessary to file an application for new electronic registration to protect right holders and maintain sound business practices.

If the electronic securities system is implemented as planned, it will significantly reduce the costs incurred by issuing securities in physical form and prevent illegal transactions

through corporations by verifying the shareholders' register and identifying changes thereof in detail. However, once the operation of the system becomes stable, it will be necessary to devise measures to expand the scope of securities to be mandatorily registered on the electronic system in order to achieve maximum effectiveness of the system.

## **2. Introduction of SPCs' Actual Borrower Disclosure System**

As mentioned above, some companies take advantage of indirect loans through SPCs in order to resolve financial difficulties. To resolve this issue, the financial supervisory agencies decided to reform the comprehensive credit information system of the Korea Federation of Banks, seeking measures in February 2015 to disclose information about the amount and actual borrower of loans contracted in the name of SPCs<sup>44</sup>.

The discussions at the time showed that the financial supervisory agencies seemingly wished to disclose the amount of loans issued to each actual borrower when SPCs borrow more than a certain amount. Although the idea was not realized, it was a meaningful attempt in that the government became fully interested in the misuse of SPC loans.

However, in order to facilitate the centralized management and utilization of credit information, credit information collection agencies of the Korea Federation of Banks, the Korea Financial Investment Association, the Korea Life Insurance Association, General Insurance Association of Korea, and the Credit Finance Association were integrated into and newly launched as "Korea Credit Information Services" in January 2016. If the SPC's actual borrower disclosure system is introduced in the current situation, it will play a significant role in resolving the shortcomings of SPCs based on the "enhanced credit information system."

## **3. Enhanced Stringency in Government Tax Audits**

Recently, questions have been raised as owners of large conglomerates have taken advantage of the public interest corporation system to strengthen their control over affiliate companies. As a response, the government entrusted the National Tax Service with the task of monitoring faithful public interest corporations through functions such as nepotistic director appointments, unfair insider trading, and excess ownership of affiliate companies' shares, thoroughly monitoring whether or not public corporations are violating their legal duties. In particular, public interest corporation monitoring teams at local tax offices are conducting comprehensive inspections of public interest corporations that are affiliated and invested by large corporations and their shareholders in order to prevent illegal inheritance and donations<sup>45</sup>.

As such, strengthening the National Tax Service's tax investigation of public interest corporations and the Fair Trade Commission's research on the actual condition of public interest corporations as mentioned above will preemptively prevent the misuse of public

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<sup>44</sup> "Special Purpose Companies' Actual Borrowers to Be Disclosed," the Korea Economic Daily, February 9, 2015, [http://news.hankyung.com/article/201502\\_0928921?nv=o](http://news.hankyung.com/article/201502_0928921?nv=o)

<sup>45</sup> Press release of the National Tax Service, September 5, 2018, "Strict Verification to Be Conducted into Public Interest Corporations' Fulfillment of the Duty under the Tax Act," p. 2.

interest corporations, which may be easily overlooked without an adequate regulatory system.

#### **4. Korea Financial Intelligence Unit's Implementation of the System for the Timely Acquisition of Beneficial Owner Information of Corporations**

It is necessary to introduce a system to allow the Korea Financial Intelligence Unit (KoFIU) and other law enforcement agencies to make timely use of beneficial owner information of legal persons and trusts, which is one of the recommendations required by FATF's international standards. In Korea, the National Tax Service holds the beneficial owner information of legal persons and trusts, etc. which can be used for such purpose.

Fortunately, the government and the National Assembly are currently pursuing the amendment of relevant laws and regulations to ensure that KoFIU is provided with the information necessary to identify the beneficial owner of property under borrowed names for the purpose of tracking money laundering (legislations authored by Representative Kim Byeong-uk, authored by Jeon Hae-cheol, and others). This is a desirable step toward an institutional improvement in terms of enhancing the transparency of legal persons and trusts.

##### **Partial Amendment Plan for the Act on Reporting and Using Specified Financial Transaction Information**

**(Bill No. 17706, December 24, 2018. Chief authored by the Representative Kim Byeong-uk)**

##### **Reason for proposal and its main contents**

Under the current law, the head of KoFIU may request the head of the relevant administrative agency to provide data to be used in analyzing specific financial transaction information in a written format that clearly states the purpose of its use. However, the information that can be requested by the head of KoFIU does not include taxation information created under the Framework Act on National Taxes. Therefore, even if taxation information is necessary to track money laundering, the principle of confidentiality for taxation information does not allow the provision of such information, which is nonetheless necessary in order to identify the beneficial owner of the property under a borrowed name. Hence, this bill is proposed to add taxation information created according to the Framework Act on National Taxes to the scope of data that the head of KoFIU can request, and to ensure that data including the detailed statement of changes in stocks, etc. held by the National Tax Service will be shared (Article 10 (1) of the Bill).

#### **5. National Trust Resister Office**

##### **International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation FATF Recommendations**

##### **E. TRANSPARENCY AND BENEFICIAL OWNERSHIP OF LEGAL PERSONS AND**

## **ARRANGEMENTS**

### **25. Transparency and beneficial ownership of legal arrangements\***

Countries should take measures to prevent the misuse of legal arrangements for money laundering or terrorist financing. In particular, countries should ensure that there is adequate, accurate and timely information on express trusts, including information on the settlor, trustee and beneficiaries, that can be obtained or accessed in a timely fashion by competent authorities. Countries should consider measures to facilitate access to beneficial ownership and control information by financial institutions and DNFBPs undertaking the requirements set out in Recommendations 10 and 22.

### **INTERPRETIVE NOTE TO RECOMMENDATION 25 (TRANSPARENCY AND BENEFICIAL OWNERSHIP OF LEGAL ARRANGEMENTS)**

3. Countries are encouraged to ensure that other relevant authorities, persons and entities hold information on all trusts with which they have a relationship. Potential sources of information on trusts, trustees, and trust assets are:
- (a) Registries (e.g. a central registry of trusts or trust assets), or asset registries for land, property, vehicles, shares or other assets.
  - (b) Other competent authorities that hold information on trusts and trustees (e.g. tax authorities which collect information on assets and income relating to trusts).
  - (c) Other agents and service providers to the trust, including investment advisors or managers, lawyers, or trust and company service providers.

### **(FATF guidance) TRANSPARENCY AND BENEFICIAL OWNERSHIP, October 2014, Page 32**

Registries: Although not required the FATF Recommendations, a centralised registry of trusts to which disclosure must be made of the information pertaining to all trusts (including information on the settlor and beneficiary) could be an effective mechanism as it would provide timely information on the trust and (if kept accurate) could provide competent authorities with access to necessary information for disclosure and international cooperation. Centralised trust registries would also ensure that beneficial ownership information is freely available to competent authorities across jurisdictions in a timely manner, without tipping off a trust under investigation. For example, establishing a central trust registry may be an effective approach where a limited number of trusts exist in a country.

□ Through Recommendation 25, the FATF recommends the competent authorities to obtain or access appropriate and accurate information on trusts in a timely fashion to verify transparent legal relationship and beneficiary owners. In the Interpretive Note of Recommendation 25, the FATF recommends that registries (e.g. a central registry) or tax authorities collect information on trusts or assets and income relating to trusts. In addition, FATF Guidance introduces methods to establish a central trust registry as an effective

mechanism to obtain information on trusts. For reference, France has established the National Registry of *Fiducies* according to Article 2020 of the Civil Code<sup>46</sup>. Following France's example, the introduction of trust registry system or the establishment of a national trust registry may be considered as an option.

## VII. Conclusion

Compared to other countries, Korea has not fully cultivated a system of legal persons and trusts. However, the real-name financial transaction system and the restriction on the opening of bank accounts under borrowed names are being implemented appropriately, and the activities of trust and company service providers are insignificant. Therefore, the risk of the misuse of legal persons and trusts in money laundering and terrorist financing seems to be considerably low at present.

However, as described in section "III. Risk for the Misuse of Legal Persons, Trusts, etc. for Money Laundering and Terrorist Financing," there have been cases of tax evasion or offshore property concealment through the establishment of overseas corporations (paper companies), and tax evasion through the establishment of domestic SPCs. This demonstrates that legal persons, trusts, etc. can be misused for concealing beneficial owners in Korea.

Considering such fact in addition to the increased usage of legal persons, trusts, etc., and the fact that SPCs are being exploited for the purpose of evading relevant regulations such as the Act on Real Name Financial Transactions and Guarantee of Secrecy, etc., the misuse of legal persons and trusts are expected to increase.

However, as mentioned above, the Korean government has already implemented a variety of policy measures and sought various preemptive countermeasures to strengthen AML/CFT as well as to facilitate taxation. In particular, when the government successfully amends the Act on Reporting and Using Specified Financial Transaction Information and lays the legal grounds for KoFIU to be provided in a timely manner with beneficial ownership information of legal persons and trusts, which are now held by the National Tax Service, the risk of legal persons, trusts, etc. being misused for money laundering and terrorist financing can be further reduced. Therefore, if the above-mentioned systems are implemented as planned, and if Korea continues its commitment to fulfill its desire and longing for a transparent economy (the stable operation of the real-name financial transaction and the real-name legal persons and trusts system), most of the vulnerabilities in terms of the transparency of legal persons, trusts, etc. will be resolved.

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<sup>46</sup> FATF, "Mutual Evaluation Executive Summary (France) (<http://www.fatf-gafi.org/media/fatf/documents/reports/mer/MER%20France%20ES%20ENG.pdf>)," p. 15.