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Sung-Soo Han
[Exclusive Column] Were the Korean representatives deceived by the ‘skillful’ claims by Lone Star Funds?

The following article was originally posted in the Daily NTN, Dr. Han’s exclusive column, "Were the Korean representatives deceived by the ‘skillful’ claims by Lone Star Funds?" on May 19, 2015. Lee & Han International translated the article for the overseas and English viewers. Original article can be found in http://www.intn.co.kr/news/articleView.html?idxno=429050.

- The recent legal turmoil brought by Lone Star Funds was, in fact, invited by the Korean government's lack of understanding on the interrelationship between tax treaty and investment agreement.

- The in-charge government officials who approved the arbitration proceedings with Lone Star Funds should be liable for the mistakes in that the arbitration request is not legally effective due to the expiration of statute of limitation and the priority of tax treaty.

Recently, a specialist’s analysis on the Korea’s historical legal dispute filed by Lone Start Funds, U.S. private equity funds, has caught the public eyes. The analysis indicated that the government officials' lack of understanding on the interrelationship between tax treaty and investment agreements resulted in the historic legal dispute, worth of US$ 5 billion.

Regardless of results of the arbitration proceedings, the relevant government officials could be subject to audit and investigations which would lead to the legal responsibilities.

One of nation’s top international tax specialists, Dr. Sung-Soo Han (he also recently passed the Washington D.C Bar exam) analyzed the related issues in his column exclusively submitted to the Daily National Tax News (the "Daily NTN").

Dr. Han pointed out that there is no reason why the Korean government should consent to Lone Star’s arbitration request from a legal perspective. And he added that he doesn’t understand why the Korean government consented to the arbitration request so easily, and more detailed analysis could have prevented the unreasonable consent by the Korean government. If the Korean government loses the case, it could be liable for $5 billion legal claims and face with the international humiliation.

He said that if we take a close look at the issues raised by Lone Star Funds through the International Centre for Settlement of Investment Disputes ("ICSID"), there are only two main issues; the first one is that Lone Star Funds was unlawfully discriminated in exercising their property rights in Korea; and, the other one is that the tax assessment made by the Korean tax authority against Lone Star Funds was not reasonable.
He also added that the reason why the situation has gotten out of hands so badly is that the Korean government didn’t correctly understand the interrelationship between tax treaties and investment agreements. The Korean government mindlessly consented to the arbitration proceeding request filed with the ICSID although the government had a chance to reject the arbitration request at the initial stage.

It seems that Lone Star Funds, U.S. private equity funds, filed the litigation under the investment agreement between Korea and Belgium knowing that the Free Trade Agreement (“FTA”) between Korea and the U.S.A. is not applicable to this case. Regardless of its litigation approach, however, it is very susceptible whether the Lone Star Funds met the legal requirements stipulated under the investment agreement and the tax treaty between Korea and Belgium.

He said that the Korean government would have noticed the Article 8(7) of the investment agreement between Korea and Belgium which states “the investor is not entitled to submit a dispute for resolution according to this Article if more than five years have elapsed from the date the investor first acquired or should have acquired knowledge of the events giving rise to the dispute”. However, despite of the Article 8(7), the Korean government accepted the arbitration request. It seems that Korean government didn’t correctly understand the hidden meanings of the contexts included in the investment agreement and the tax treaty between Korea and Belgium.

With respect to Lone Star’s claims on unlawful discrimination by the Korean government in the course of selling its shares of the Korea Exchange Bank (“KEB”), 5 years of statute of limitation stipulated under the Article 8(7) of the investment agreement had already expired because the time when the Korean Financial Services Commission (“FSC”) unapproved sales of the KEB’s shares is the year of 2006, and the time when Lone Star Funds sent a notification of arbitration intention to the Korean government is May, 2012, and the time when Lone Star Funds filed the claims to the ICSID is November, 2012.

In addition, with respect to the tax assessments which were made in 2005 and 2007, benefits of any treatment, preference or privilege for the avoidance of double taxation should be given in accordance with the Korea-Belgium tax treaty rather than the investment agreement as provided in the Article 3(4) of the investment agreement.

As far as the taxation issue is concerned, the tax treaties have a priority over the investment agreements. Thus, it is absolutely wrong that Lone Star Funds requested the ICSID’s arbitration proceedings in relation to the taxation issues. Lone Star’s unreasonable taxation claim based on the investment agreement is not in accordance with the contexts of the investment agreement itself.

The Article 3(4) of the investment agreement has a meaning that if taxation issues arise out of investment activities, these taxation issues should be handled based on the tax treaty, not the investment agreement.

Thus, taxation issues cannot be subject to the arbitration proceeding when there is a tax treaty applicable. In addition, with respect to the tax assessments made by the Korean government, Lone Star Funds voluntarily gave up the tax treaty benefit (i.e., relief from double taxation through mutual agreement procedure) which is allowed under the Korea-Belgium tax treaty by taking the domestic tax appeal procedures, and finally lost the case in the Korea Supreme Court. Therefore, there are no further legal remedies available to Lone Star Funds. And, it is common in the international taxation practices.

According to Dr. Han, Lone Star Funds’ first claim based on the discriminative treatments by the Korean government has already passed the statute of limitation under the investment agreement, and its second claim based on the unreasonable taxation cannot be entitled to the arbitration proceeding since taxation issues should be resolved in accordance with the Korea-Belgium tax treaty rather than the investment agreement.

Thus, the Korean government should have not accepted the arbitration request by Lone Star Funds based on the above mentioned legal grounds from the outset of this dispute.

The Article 25 of Chapter II of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States provides that “The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally”.

Dr. Han said “I don’t understand why the Korean government consented to the arbitration request and it should have denied the consent from the outset of the turmoil based on the above mentioned legal grounds. If the Korean government had made a mistake in
According to the recent press report, the Korea's top ranking officials were appointed as witnesses of the proceedings including former finance minister Han Deok-soo, former chief of Financial Services Commission Kim Seok-dong, former chief of Financial Services Commission Cheon Gwang-woo, former policy coordinating minister at the prime minister's office Gwon Tae-sin, former chairman of Hana Financial Group Kim Seung-yoo, former vice governor of Financial Supervisory Service Kim Choong-hei and former director of tax policy at OECD policy center Cho Gyu-beom. Most of them are to be called upon as a witness in the first trial scheduled from May 15th to May 25th and the second trial scheduled from June 29th to July 8th.

This means that the arbitration proceeding has already stepped into an evidential dispute stage. We can easily forecast how much litigation costs the Korean government will spend in the near future.

In addition, the Korean government is fighting against one of top U.S. funds in its backyard. Thus, the possibility that the Korean government will be defeated in the litigation is very high.

And, if it happens, the Korean government and its people should bear the historic indemnity liability, worth of US$ 5 billion (delay of approval of selling shares = US$ 3.5 billion, unreasonable taxation = US$ 1.5 billion), and will eventually lose their face in the international community.

Lastly Dr. Han kindly advised to the Korean government that "If there is a mistake unwillingly made by the Korean government, the government should frankly acknowledge it and seek a workable solution to get out of the turmoil. If the Korean government consented to the arbitration proceeding by mistake, the Korean government should ask ICSID to dismiss the case based on a well-organized legal approach.”

YC Chung/ kukse219@naver.com

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