

**Bond University**

## **DOCTORAL THESIS**

**Perfecting the Chinese Law of Trusts: Critical and Comparative Study of the Australian and Chinese Law of Trusts.**

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# **Perfecting the Chinese Law of Trusts**

**– A Critical and Comparative Study of  
the Australian and the Chinese Law  
of Trusts**

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## **CERTIFICATION**

This thesis is submitted to Bond University in fulfillment of the requirement for the Degree of Doctor of Philosophy.

This thesis represents my own work and contains no material which has been previously submitted for a degree or diploma at Bond University or any other institution, except where due acknowledgement is made.

Signature.....

Date .....

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## SUMMARY

The rapid expansion of the Chinese economy has made China aware of the importance of the rule by law. Perfecting its legal system and expanding its economy are the two goals of modern China. Many laws and regulations have been enacted since the economic reform was launched at the end of 1970s. The enactment of the Chinese *Law of Trusts* is an important step in the refinement of the Chinese legal system.

This thesis aims to identify the deficiencies in the Chinese *Law of Trusts* by giving a critical and comparative study of the Australian and the Chinese trusts law, so as to propose amendments to the Chinese *Law of Trusts*.

This thesis is divided into two Parts, and seven Chapters. Part One, which comprises five chapters, is a comparative study of the Australian and the Chinese trusts law. It also discusses the laws of trusts in other important Common Law and Civil Law jurisdictions. Chapter 1 of this Part deals with the basic concept of the trust. It introduces and discusses the definition, and the characteristics of the trust, the comparison between the trust and other similar concepts, and the classification of trusts. Chapter 2 deals with the creation of express trusts. With respect to the rights and duties of the trust parties, Chapter 3 gives a detailed discussion. Chapter 4 examines the variation and termination of trusts. The last chapter of Part One, Chapter 5, specifically analyses the charitable trusts.

Part Two comprises two chapters: Chapter 6 and Chapter 7. Chapter 6 discusses the practical impact of the Chinese *Law of Trusts* on the Chinese State-owned enterprise reform, which has been progressing for more than two decades in China.

Chapter 7 is a general concluding chapter. It pinpoints the deficiencies in the Chinese *Law of Trusts*, analyses the reasons for the deficiencies, and suggests two solutions to

improve the *Law*: namely, to improve the existing provisions of the *Law* and to adopt eclectically the elaborate concepts of the Australian law of trusts.

# TABLE OF CONTENTS

List of Abbreviations .....	xvi
-----------------------------	-----

<b>Introduction .....</b>	<b>1</b>
---------------------------	----------

## **PART ONE**

<b>COMPARATIVE STUDIES OF THE AUSTRALIAN AND THE CHINESE LAW OF TRUSTS .....</b>	<b>3</b>
--	----------

### **Chapter 1**

<b>The Basic Concept of the Trust .....</b>	<b>4</b>
---	----------

1.1 The Definition of the Trust .....	4
---------------------------------------	---

1.1.1 The Definition of the Trust under the Common Law .....	4
--	---

1.1.2 The Definition of the Trust under the Civil Law .....	7
---	---

1.1.2.1 The definitions of the trust given in the Civil Law jurisdictions other than China .....	10
---	----

1.1.2.2 The definition of the trust given by the Chinese Law of Trusts .....	13
--	----

1.2 Characteristics of Trusts .....	21
-------------------------------------	----

1.2.1 Characteristics of Trusts under the Common Law .....	21
--	----

1.2.1.1 Paramountcy of the trust .....	21
--	----

1.2.1.2 Separation of the legal and equitable ownership .....	23
---	----

1.2.1.3 Severance characteristic of the trust property .....	24
--	----

1.2.1.4 Elasticity of trust .....	26
-----------------------------------	----

1.2.1.5 Continuity of trust.....	32
1.2.1.6 Concealment of trust.....	34
1.2.2 Characteristics of trusts under the Civil Law.....	35
1.2.2.1. The common characteristics of trusts under the Chinese Law of Trusts .....	35
1.2.2.2 The Distinctive Characteristics of Trusts under the Chinese Law of Trusts.....	42
1.3 Comparison between Trust and Other Similar Concepts.....	46
1.3.1 Trust and Debt.....	46
1.3.1.1 Trust and debt under the Common Law .....	46
1.3.1.2 Trust and debt under the Civil Law .....	49
1.3.2 Trust and Contract.....	52
1.3.2.1 Trust and contract under the Common Law .....	52
1.3.2.2 Trust and contract under the Civil Law .....	55
1.3.3 Trust and Agency.....	64
1.3.3.1 Trust and agency under the Common Law .....	64
1.3.3.2 Trust and agency under the Civil Law .....	66
1.3.4 Trust and Bailment.....	74
1.3.4.1 Trust and bailment under the Common Law .....	74
1.3.4.2 Trust and bailment under the Civil Law .....	76
1.4 Classification of Trusts .....	79
1.4.1 Classification of Trusts under the Common Law .....	79
1.4.1.1 Express trusts .....	79
1.4.1.2 Resulting trusts.....	80

1.4.1.3 Constructive trusts .....	81
1.4.2 Classification of Trusts under the Civil Law .....	82
1.4.2.1 Express trusts and statutory trusts.....	84
1.4.2.2 Private trusts and charitable trusts .....	84
1.4.2.3 Trusts created inter vivos and testamentary trusts .....	86

## **Chapter 2**

### **Creation of Express Trusts ..... 90**

2.1 Capacity to Create an Express Trust.....	91
2.1.1 The Capacity of the Settlor and the Testator .....	91
2.1.2 The Capacity of the Trustee.....	92
2.2 The Three Certainties.....	93
2.2.1 Certainty of Intention.....	93
2.2.1.1 Certainty of intention under the Common Law .....	93
2.2.1.2 Certainty of intention under the Civil Law .....	96
2.2.2 Certainty of Subject Matter.....	100
2.2.2.1 Certainty of subject matter under the Common Law .....	100
2.2.2.2 Certainty of subject matter under the Civil Law.....	100
2.2.3 Certainty of Objects .....	101
2.2.3.1. Certainty of objects under the Common Law .....	101
2.2.3.2 Certainty of Objects under the Civil Law .....	107
2.3 Complete Constitution of Voluntary Trusts.....	111
2.3.1 Complete Constitution of Voluntary Trusts under the Common Law....	111
2.3.1.1 The general rule to complete a voluntary transfer .....	112

2.3.1.2	The application of the general rule to various properties .....	114
2.3.2	Complete Constitution of Trust under the Civil Law .....	119
2.3.2.1	The time of formation of a trust contract and the time of creation of a trust .....	120
2.3.2.2	The transfer of the trust property under the Civil Law .....	129
2.4	Writing Requirements for the Creation of Certain Trusts .....	134
2.4.1	Writing Requirements under the Common Law .....	134
2.4.2	Writing Requirements under the Civil Law.....	139
2.4.2.1	Writing requirements of a trust inter vivos.....	140
2.4.2.2	The formalities of a will.....	143
2.5	Legality of Trusts .....	145
2.5.1	Legality of Trusts under the Common Law .....	146
2.5.1.1	The American position.....	146
2.5.1.2	The English position .....	147
2.5.1.3	The Australian position.....	150
2.5.2	Legality of Trusts under the Civil Law .....	154
2.5.2.1	Trusts for illegal purpose or purposes.....	155
2.5.2.2	Trusts to circumvent the law.....	157
2.5.2.3	Trusts for litigation .....	158
2.5.2.4	Trusts to defraud creditors .....	160

## Chapter 3

### **Trust Parties..... 163**

3.1	The Trustee .....	163
-----	-------------------	-----

3.1.1 Duties of a Trustee .....	164
3.1.1.1 Duties of a trustee under the Common Law .....	165
3.1.1.2 Duties of a trustee under the Civil Law .....	179
3.1.2 Liabilities of a Trustee .....	194
3.1.2.1 Liabilities of a trustee under the Common Law.....	195
3.1.2.2 Liabilities of a trustee under the Civil Law .....	199
3.1.3 Powers of a Trustee.....	203
3.1.3.1 Powers of a trustee under the Common Law .....	204
3.1.3.2 Powers of a trustee under the Civil Law .....	207
3.1.4 Rights of a Trustee .....	209
3.1.4.1 Rights of a trustee under the Common Law .....	209
3.1.4.2 Rights of a trustee under the Civil Law .....	217
3.2 The Settlor and the Beneficiary .....	225
3.2.1 The Settlor and the Beneficiary under the Common Law .....	225
3.2.1.1 Right to extinguish the trust.....	226
3.2.1.2 Right to compel performance.....	227
3.2.1.3 Right to trace trust property .....	228
3.2.2 The Settlor and the Beneficiary under the Civil Law .....	229
3.2.2.1 The position of the settlor .....	229
3.2.2.2 Rights of the settlor and the beneficiary .....	230
3.2.2.3 Duties of the settlor and the beneficiary .....	239

## **Chapter 4**

### **Variation and Termination of Trusts ..... 241**

4.1 Variation and Termination of Trusts under the Common Law.....	242
4.1.1 Variation and Termination by the Settlor, the Beneficiary and the Trustee .....	242
4.1.1.1 Variation and termination by the settlor .....	242
4.1.1.2 Variation and termination by the beneficiary .....	243
4.1.1.3 Variation and termination by the trustee.....	246
4.1.2 Variation and Termination by the Court.....	247
4.2 Variation and Termination of Trusts under the Civil Law .....	250
4.2.1 Variation of Trusts .....	250
4.2.2 Termination of Trusts .....	254
4.2.2.1 The termination of trusts in Japan, South Korea and Taiwan.....	255
4.2.2.2 The termination of trusts in China .....	258

## **Chapter 5**

### **Charitable Trusts..... 264**

5.1 The Nature of Charitable Trusts .....	264
5.1.1 Definition of Charitable Trusts .....	264
5.1.2 Distinction between Charitable Trusts and Other Express Trusts .....	266
5.2. Charitable Purposes .....	271
5.2.1 Charitable Purposes under the Common Law .....	271
5.2.1.1 The Charitable purposes Enumerated in the Preamble to the Statute of Charitable Uses 1601 (Eng).....	271
5.2.1.2 The modern four categories of charitable purposes.....	272
5.2.1.3 The essence of a charitable purpose.....	273

5.2.2 Charitable Purposes under the Civil Law .....	287
5.3 Categories of Charitable Trusts .....	291
5.3.1 Categories of Charitable Trusts under the Common Law .....	291
5.3.1.1 The trusts for the relief of poverty .....	291
5.3.1.2 The trusts for the advancement of education .....	293
5.3.1.3 The trusts for the purposes beneficial to the community .....	295
5.3.2 Categories of Charitable Trusts under the Civil Law .....	298
5.3.2.1 The categories of charitable trusts in Japan, South Korea and Taiwan .....	298
5.3.2.2 The categories of charitable trusts in China.....	298
5.4 The Application of the Cy-Pres Doctrine .....	302
5.4.1 The Cy-Pres Doctrine under the Common Law .....	302
5.4.1.1 Initial impossibility .....	302
5.4.1.2 Subsequent impossibility .....	306
5.4.1.3 The statutory cy-pres.....	309
5.4.2 The Cy-Pres Doctrine under the Civil Law .....	311
5.4.2.1 The circumstances under which the cy-pres is applied.....	312
5.4.2.2 The requirement of the general charitable purpose.....	314
5.4.2.3 Variation of the terms of charitable trust and cy-pres.....	317
5.5 The Relationship between the Chinese Law of Charitable Donation and the Law of Trusts .....	319
5.5.1 The Main Contents of the Chinese Law of Charitable Donation.....	319
5.5.2 The Relationship between the Chinese Law of Trusts and the Chinese Law of Charitable Donation.....	321

## **PART TWO**

### **PERFECTING THE CHINESE LAW OF TRUSTS ..... 325**

#### **Chapter 6**

#### **The Practical Impact of the Chinese Law of Trusts on State-Owned Enterprises in China ..... 326**

6.1 The Different Phases in the SOE Reform and the Theories Which Inspired Them .....	328
6.1.1 The First Phase: Expanding the Autonomous Managerial Rights of SOEs (1979 – 1984).....	329
6.1.2 The Second Phase: the Separation of Rights of Management from Ownership (1984 – 1993) .....	330
6.1.2.1 The two periods of SOE reform in the second phase.....	331
6.1.2.2 The deficiencies in the theory of the separation of two rights .....	334
6.1.3 The Third Phase: A Legal Person’s Property Rights (1993 – Present).....	337
6.1.3.1 The confusion caused by the Chinese Company Law .....	339
6.1.3.2 The discussion of the nature of a legal person’s property rights .....	346
6.1.3.3 The deficiencies in the theory of a legal person’s property rights .....	349
6.2 The Trust: the Most Efficient Instrument for Administering and Managing the State-owned Assets .....	353
6.2.1 The Application of the Trust to the SOEs.....	353
6.2.1.1 The two types of SOEs .....	353
6.3.1.2 The application of the trust to the SOEs .....	354

6.3.1.3 The significance of the application of the trust concept to the assets traded by the SOEs.....	356
6.3.2 The Application of the Trust to the Non-SOCs .....	359

## **Chapter 7**

### **Towards Perfecting the Chinese Law of Trusts..... 363**

7.1 The Deficiencies in the Chinese Law of Trusts .....	363
7.1.1 Deficiencies.....	363
7.1.1.1 Deficiencies in the provisions regulating the methods of creating a trust .....	363
7.1.1.2. Improper expansion of the rights of the settlor .....	368
7.1.1.3 Mono-type of trusts.....	372
7.1.2 The Reasons for the Deficiencies in the Chinese Law of Trusts .....	376
7.2 Perfecting the Chinese Law of Trusts.....	381
7.2.1 Remedying the Existing Deficient Provisions of the Chinese Law of Trusts .....	382
7.2.1.1 Supplementing the methods of the creating a trust.....	382
7.2.1.2 Recasting the rights of the settlor and conferring more rights on the beneficiary.....	384
7.2.1.3 Conferring more specific powers on the trustee .....	387
7.2.2 Accepting Selectively the Advanced Legal Principles of the Trusts Law in Australia and other Common Law Countries .....	388
7.2.2.1 Accepting declaration trusts, resulting trusts and constructive trusts .	389
7.2.2.2 Developing a concept of fiduciary relationships .....	395

<b>Appendix .....</b>	<b>399</b>
<b>Bibliography: .....</b>	<b>417</b>

# List of Abbreviations

1. CPC: The Communist Party of China;
2. CRS: The Contract Responsibility System;
3. DCRDSOE: The Decision on Important Issues Concerning the Reform and Development of the State-Owned Enterprises in China.
4. DESME: The Decision Concerning the Establishment of the Socialist Market Economy of the Communist Party of China;
5. DRES: The Decision Concerning the Reform of the Economic System of the Communist Party of China;
6. GPCL, the General Principles of Civil Law of the People's Republic of China;
7. LIEOWP: The Law of Industrial Enterprises under the Ownership of the Whole People;
8. NPC, the Chinese National People's Congress;
9. ROC, the Republic of China (Taiwan);
10. PRC, the People's Republic of China;
11. SOC: State-owned company;
12. SOCs: State-owned companies;
13. SOE: State-owned enterprise;
14. SOEs: State-owned enterprises
15. TRCRS: Temporary Rules on Contract Responsibility System of the Enterprises under the Ownership by the Whole People

# Introduction

The rapidly developing Chinese Economy has exposed, since the 1980s, the deficiencies in its property law. The existing Chinese property law is not sufficiently sophisticated to regulate the increasingly complex Chinese economy efficiently. China has been seeking a new legal system to improve the Chinese economy by expanding and refining the laws governing its property administration and property transactions. For many years, China had cast its eye on the law of trusts and realized the important role which a law of trusts plays in administering and disposing of property in common law jurisdictions. Therefore, China envisioned the introduction of a Chinese law of trusts to make its economy more efficient.

In 1993, the Standing Committee of the National People's Congress of China began engaging experts and scholars to draft a Chinese law of trusts. After eight years and three drafts, the Chinese *Law of Trusts* was enacted on April 28, 2001, in the Twenty First Session of the Standing Committee of the Ninth Chinese National People's Congress. The Chinese *Law of Trusts* has a total of 74 articles and is divided into seven chapters as follows: Chapter One, General Provisions; Chapter Two, Creation of Trusts; Chapter Three, Trust property; Chapter Four, Trust Parties; Chapter Five, Variation and Termination of Trusts; Chapter Six, Charitable Trusts; and Chapter Seven, Supplementary Provision. Except that Chapter Seven comprises only one article, namely, article 74, which provides for the date from which the *Law* came into effect, other chapters each embody five or more than five articles.<sup>1</sup>

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<sup>1</sup> . See the appendix "The Law of Trusts of the People's Republic of China".

The enactment of the Chinese *Law of Trusts* is enormously significant in Chinese legal history and is a milestone in the development of the Chinese legal system. However, because the law of trusts is an institution peculiar to Common Law countries and the Chinese legal system derives from the Civil Law system, in the course of accepting and transplanting trusts into China, China has had to face the conflict between the two different legal systems and has had to compromise in order to mingle the law of trusts with the Chinese legal system. Chinese legal experts and scholars were uncertain as to how a law of trusts could best be accommodated within the Chinese legal system, so that the current Chinese *Law of Trusts* has many deficiencies. In practice, such deficiencies will inevitably limit the operation of trusts as well as the development of trusts. Therefore, the question of how to perfect the Chinese *Law of Trusts* and to let it function optimally in China has become the most urgent task for Chinese legal experts and scholars.

This thesis will examine the Chinese *Law of Trusts* through critical and comparative studies of mainly the Chinese and Australian law of trusts to identify the deficiencies in the Chinese *Law of Trusts* and to propose suggestions as to how to perfect that *Law*.

# **PART ONE**

## **COMPARATIVE STUDIES OF THE AUSTRALIAN AND THE CHINESE LAW OF TRUSTS**

This Part will focus on the comparative studies of the Chinese and Australia Law of Trusts so as to lay a foundation for perfecting the Chinese *Law of Trusts*. Technically, the comparative studies are to be undertaken under the title of the Common Law and the Civil Law respectively. The law of trusts under both the Common Law and the Civil Law jurisdictions will be drawn upon for comparative studies, but the comparative studies are mainly based on the Australian and the Chinese law of trusts. The comparative studies of the Australian and the Chinese law of trusts will be carried out basically according to the order of the chapters of the Chinese *Law of Trusts* and will begin with the basic concept of the trust.

# Chapter 1

## The Basic Concept of the Trust

### 1.1 The Definition of the Trust

#### 1.1.1 The Definition of the Trust under the Common Law

At the start of his magisterial treatise, *The Law of Trusts*, Scott cites Maitland's accolade on the trust, which reads: "If we were asked what is the greatest and most distinctive achievement performed by Englishmen in the field of jurisprudence I cannot think that we should have any better answer to give than this, namely, the development from century to century of the trust idea."<sup>2</sup> In deed, "Of all the exploits of Equity the largest and the most important is the invention and development of the Trust."<sup>3</sup>

The trust is a legal device for administering and disposing of properties. It originated, and has been developed, in equity. Although some scholars and judges have attempted to define a trust, it is difficult to find a convincing and satisfactory definition of a trust.

From the judicial perspective, an Australian judge, Mayo J.,<sup>4</sup> propounded a general definition of the trust, saying:

No definition of a "trust" seems to have been accepted as comprehensive and exact ... Strictly it refers, I think, to the duty or aggregate accumulation of obligations that rest upon a person described as a trustee. The responsibilities are in relation to property held by him, or under his control. That property he will be compelled by a court in its equitable jurisdiction to administer in

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<sup>2</sup> . Scott and Fratcher: *The Law of Trusts* (1987, 4<sup>th</sup> ed), Volume I, §1.

<sup>3</sup> . F. W. Maitland: *Equity* (1936), p 23.

<sup>4</sup> . *Re Scott* [1948] S.A.S.R 193 at 196.

the manner lawfully prescribed by the trust instrument, or where there be no specific provision written or oral, or to the extent that such provision is invalid or lacking, in accordance with equitable principles. As a consequence the administration will be in such a manner that the consequential benefits and advantages accrue, not to the trustee, but to the persons called cestuis que trust, or beneficiaries, if there be any, if not, for some purpose which the law will recognise and enforce. A trustee may be a beneficiary, in which case advantages will accrue in his favour to the extent of his beneficial interest.

In addition, section 2 of the *Restatement of Trusts 2d* states:

A trust, as the term is used in the Restatement of this Subject, when not qualified by the word “charitable”, “resulting” or “constructive”, is a fiduciary relationship with respect to property, subjecting the person by whom the title to the property is held to equitable duties to deal with the property for the benefit of another person, which arises as a result of a manifestation of an intention to create it.

From the academic perspective, Ford and Lee defined a trust as “an obligation enforceable in equity which rests on a person (the trustee) as owner of some specific property (the trust property) to deal with that property for the benefit of another person (the beneficiary) or for the advancement of certain purposes”.<sup>5</sup>

Evans defined a trust as “existing where the owner of property is obliged to deal with that property for the benefit of some other person or persons, or for some purpose recognized by law”.<sup>6</sup>

However, Martin suggested, “many attempts have been made to define a trust, but none of them has been wholly successful. It is more useful to describe than to define a trust...” and stated that “a trust is a relationship recognized by equity which arises where

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<sup>5</sup> . Ford and Lee: *Principles of the Law of Trusts* (1996, 3<sup>rd</sup> ed), para [1000].

<sup>6</sup> . Michael Evans: *Equity and Trusts* (2003), p 294.

property is vested in (a person or) persons called the trustees, which those trustees are obliged to hold for the benefit of other persons called *cestuis que trust* or beneficiaries”.<sup>7</sup>

Although Meagher and Gummow have stated that a trust is created “when the holder of a legal or equitable interest in certain property is bound by an obligation cognizable and enforceable in equity, to hold that interest not for his own exclusive benefit but for the benefit, as to the whole or part of such interest, of another person or persons, or of himself and such other persons, or for some object or purpose permitted by law”, they have conceded that “that is not the definition of a trust, but a description”.<sup>8</sup>

Despite the different definitions of the trust, they commonly express the separation of legal and equitable ownership between the trustee and the beneficiary and the elements of a trust, which comprise the trustee, the beneficiary or trust purpose, and the trust property. Usually, the trustee holds the legal title to the trust property. In *Hardoon v Belilios*, Lord Lindley said:<sup>9</sup>

All that is necessary to establish the relation of trustee and cestui que trust is to prove that the legal title was in the plaintiff [trustee] and the equitable title in the defendant [beneficiary].

However, in the case of a sub-trust, what the trustee holds is not a legal title, but an equitable title.<sup>10</sup> The beneficiary of a sub-trust is called a sub-beneficiary.

No matter how a trust is defined or described, all trusts share several elements: the trustee, the beneficiary or trust purpose, and the trust property. A trust must have a trustee or trustees who hold a legal or equitable interest in the trust property. The trustee may be appointed by the settlor or the testator/testatrix, or exceptionally, by the court. The settlor

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<sup>7</sup> . Jill E. Martin: *Modern Equity* (1997, 15<sup>th</sup> ed), p 45.

<sup>8</sup> . Meagher and Gummow: *Jacobs’ Law of Trusts in Australia* (1997, 6<sup>th</sup> ed), para 101.

<sup>9</sup> . [1901] AC 118 at 123.

<sup>10</sup> . *Gilbert v Overton* (1864) 2 H & M 110; 71 ER 402.

can be the trustee or one of the trustees, however, if the trustee is not appointed effectively, such as the appointment of a deceased person as trustee, or the appointed trustee disclaims the office, the trust will not fail for want of a trustee. The court will appoint a trustee to carry out the trust.

Again, a trust must have a beneficiary or a purpose recognized by law, for whose benefit or for which, the trustee holds the trust property. Any person may be selected as the beneficiary to enjoy the beneficial interests in the trust property. Even a trust can be created for the benefit of a person who does not exist at the time the trust is created, such as an unborn person,<sup>11</sup> although such unborn person cannot be a present beneficiary. A trustee may be appointed as one of the beneficiaries, but he/she cannot be the sole beneficiary. Where a trust does not have any ascertainable beneficiary, it must have a charitable purpose, which is then enforced by the Attorney-General on behalf of the Crown.

Moreover, a trust must have ascertainable trust property. It is a general principle that all kinds of property can be made the subject-matter of a trust, no matter whether they are real or personal; corporeal or incorporeal; legal or equitable. However, there cannot be a trust if its subject matter cannot be identified.

### **1.1.2 The Definition of the Trust under the Civil Law**

Under the Civil Law, because there is no division of equity and common law, the duality of ownership does not exist. According to property law under the Civil Law, ownership means absolute ownership and it is an exclusive right of an owner. Generally, ownership is defined as the absolute right of the owner of a thing, within the limitation of

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<sup>11</sup> . Meagher and Gummow: *Jacobs' Law of Trusts in Australia* (1997, 6<sup>th</sup> ed), para 107; Don Chalmers: *Introduction to Trusts* (1988), p 2; *Restatement of Trusts* 2d §2, illustration 2, j.

laws, to dominate the thing freely and to exclude others from interfering with it. For example, article 903 of the German *Civil Code* provides:<sup>12</sup>

Within the limitation of not violating the law and infringing on a third person's right, the owner of a thing shall dispose of the thing freely and to exclude others from interfering with it.

Also, article 765 of the *Civil Code* of ROC defines ownership as:

The right, within the limits of the law or ordinances, freely to use, receive benefits from, dispose of, and to exclude others from interfering with things.

In China, ownership is defined by article 71 of the Chinese *General Principles of Civil Law* (GPCL) as follows:<sup>13</sup>

'Property ownership' means the owner's rights to lawfully possess, utilize, profit from and dispose of his property.

Since ownership is the right of an owner to dominate the thing and to exclude others from interfering with it, the contents of ownership embody two aspects, namely the dominative rights (dominative incidents) and the rights of exclusion (exclusive incidents). The dominative rights of ownership mean that an owner of a thing directly and actively controls and dominates the thing, such as the right to possess, the right to use, or the right to dispose of the thing. The rights of exclusion mean an owner of a thing can exclude others from interfering with his/her exercising the dominative rights, such as the right to demand the removal of a hindrance, the right to demand the removal of a danger of

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<sup>12</sup> . See also the Austrian *Civil Code*, article 354; the Swiss *Civil Code*, article 641; the Italian *Civil Code*, article 832.

<sup>13</sup> . See also the *French Civil Code*, article 544 and the Japanese *Civil Code*, article 206. Although there is no express reference to the right of exclusion, the definition of ownership in the Chinese GPCL, the *French Civil Code*, and the Japanese *Civil Code* assumes that the right of exclusion is embodied in other rights. However, the first Draft of the Chinese *Civil Code*, which was examined in the Thirty-First Session of the Standing Committee of the Ninth NPC on December 23, 2002, adopted the definition of ownership as: "Ownership means, within the limitation of the law, the owner's absolute right to dominate his/her property and to exclude others from interfering with it". Book Two, "Property Rights" of the Draft of the Chinese Civil Code can be retrieved from <http://www.civillaw.com.cn/elisor/content.asp?type='立法聚焦'&programid=2&id=18>.

infringement, and the right to demand the return or restoration of the property. Where the owner is interfered with by others when he/she exercises the dominative rights of ownership, he/she is entitled to remove the interference to restore his/her ownership. An owner can exercise the rights of exclusion only when his/her ownership has been interfered with by others. Under the Civil Law, theoretically, ownership does not merely mean the dominative rights. It is regarded as a combination of the dominative rights and the rights of exclusion and the latter rights are regarded as protection of the exercise of the former rights.

According to the traditional theory of ownership under the Civil Law and article 71 of the Chinese GPCL, the dominative rights of ownership comprise four incidents: the right to possess; the right to use; the right to benefit; and the right of disposal. Some of these incidental rights, such as the right to possess, the right to use, and the right to benefit, can be separated from the owner. For example, when an owner of a bicycle lends the bicycle to another person, the right to possess and the right to use are separated from the owner and enjoyed by that person. However, the right of disposal is different. The right of disposal means that an owner of a thing has the right to dispose of the thing in any way he or she likes. It is divided into factual disposal, such as consumption, waste, destruction of the thing; and legal disposal, such as the transfer of the thing to others or the creation of an encumbrance on the thing.

The right of disposal is an essential incident and the symbol of ownership. It cannot be separated from the owner and be enjoyed by a non-owner unless the non-owner is so authorized by the owner. Usually an owner of a thing will not lose ownership so long as he/she he is entitled to dispose of the thing after other dominative incidents are separated from him/her, but he/she will lose the ownership if he/she has lost the right of disposal.

Because of the right of disposal, there cannot be two ownerships of the same thing simultaneously. Otherwise, it would conflict when the owners of the two ownerships exercise their rights of disposal. Thus, because only the owner of a thing may dispose of it, there exists the principle of “one right to one thing” under the Civil Law.

The “one right to one thing” principle means that there cannot be two or more property rights to the same thing if the effectiveness (contents) of the property rights is not different, such as two absolute ownerships or two exclusive servitudes.<sup>14</sup> The principle requires that two or more absolute ownerships cannot exist simultaneously over the same thing. Other property rights derive from ownership, but these derivative rights are not rights of ownership.

Because the duality of ownership under the Common Law violates the “one right to one thing” principle under the Civil Law, the laws of trusts of the Civil Law jurisdictions have to consider the conflict between, on the one hand, the duality of ownership under the Common Law and, on the other hand, the “one right to one thing” principle when they define a trust. They all avoid referring to the nature of the property rights of the trustee and the beneficiary in their definitions of the trust, so the definitions of the trust given in the laws of trusts under the Civil Law jurisdictions are different from those given in the Common Law countries.

### ***1.1.2.1 The definitions of the trust given in the Civil Law jurisdictions other than China***

To define a trust, article 1 of the Japanese *Law of Trusts* provides:

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<sup>14</sup>. Tiansanhuiming (Japan): *The Property Law* (2001, Chinese edition), p 11.

The trust within the meaning of this Law shall signify to transfer or otherwise dispose of a property right and cause another person to administer or dispose of the property in accordance with a specific purpose.

It is a vague definition and it is quite different from the definitions given under the Common Law. It does not include the terms “trustee” and “beneficiary”, and it even ignores the beneficiary by only providing to cause another person (the trustee) to “administer or dispose of the property in accordance with a specific purpose”.

Article 1 (2) of the South Korean *Law of Trusts* provides:

The trust within the meaning of this Law shall signify the legal relationship, under which the creator, on the basis of the special trust relationship between him/her and the trustee, transfers his/her property to the trustee and direct the trustee to administer or dispose of the property for the beneficiary or for specific purpose or purposes.

This provision of the South Korean *Law of Trusts* regards the trust as a kind of legal relationship. Article 1(1) of the *Law* first provides that “the purpose of the Law is to regulate the general private legal relationship concerning trust”. The definition made by this article is more similar to a definition of trust under the Common Law than the corresponding article in the Japanese *Law of Trusts*. However, it avoids referring to the nature of the property rights of the trustee and the beneficiary.

Article 1 of the *Law of Trusts* of ROC provides:

The trust within the meaning of this Law shall signify the relationship, under which the settlor/testator transfers or otherwise disposes of a property right and causes the trustee to administer or dispose of the trust property for the beneficiary or for specific purpose.

This definition is similar to the definition of the South Korean *Law of Trusts*, namely, although it provides for the transfer of the property rights, it does not refer to the nature of the property rights of the trustee and beneficiary.

The above definitions represent the elasticity of Asian Civil Law jurisdictions in accepting the law of trusts under the Common Law. They avoid raising conflict between the duality of ownership of the trust under the Common Law and the “one right to one thing” principle under the Civil Law. In the meantime, the trustee is vested with a sufficient property right by the transfer of the trust property from the settlor to the trustee.

However, in respect of dealing with the duality of ownership of the trust, the Canadian Quebec *Civil Code* provides that a trust is only a relationship of administering and managing trust property which is independent of all the trust parties. That means that none of the trust parties has real rights to the trust property. Articles 1260 and 1261 of Quebec *Civil Code* provide respectively:

1260: A trust results from an act whereby a person, the settlor, transfers property from his patrimony to another patrimony constituted by him which he appropriates to a particular purpose and which a trustee undertakes, by his acceptance, to hold and administer.

1261: The trust patrimony, consisting of the property transferred in trust, constitutes a patrimony by appropriation, autonomous and distinct from that of the settlor, trustee or beneficiary and in which none of them has any real right.

It is very difficult to understand article 1261 of the Code, because it cannot explain who has the real right to the trust property since none of the trust parties has any.

### **1.1.2.2 The definition of the trust given by the Chinese Law of Trusts**

Article 2 of the Chinese *Law of Trusts* defines a trust by providing:

The ‘trust’ within the meaning of this law shall signify the juristic act under which a settlor/testator, on the basis of trusting a trustee, mandates his/her property rights to the trustee who, according to the will of the settlor/testator, administers or disposes of the property in his/her own name for the interests of the beneficiary or for other specific purpose.

This definition explains the following traits of a trust under the Chinese *Law of Trusts*. First, the trust is a kind of juristic act. According to article 54 of the Chinese GPCL, “a civil juristic act shall be the lawful act of a citizen or legal person to establish, vary, or terminate civil rights and obligations”. Also, “a civil juristic act shall meet the following requirements: (1) the actor has relevant capacity for civil conduct; (2) the intention expressed is genuine; and (3) the act does not violate the law or the public interest”.<sup>15</sup> Under Chinese civil law, an act usually refers to a legal relationship. For example, agency can be regarded as an act of an agent as well as a relationship between the principal and the agent; similarly, a contract can be regarded as an act as well as a relationship of the contract parties. Although a trust is regarded either as an act<sup>16</sup> or a relationship<sup>17</sup>, it is merely a difference of expressions or of emphasis under the Civil Law, and it is not a distinction in essence.

Secondly, the settlor/testator mandates his/her property rights to the trustee on the basis of trust. That means because the creator has confidence in the trustee, he/she

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<sup>15</sup> . The Chinese GPCL, article 55.

<sup>16</sup> . The Japanese *Law of Trusts*, article 1; the Quebec *Civil Code*, article 1260.

<sup>17</sup> . The South Korean *Law of Trusts*, article 1 (2); the *Law of Trusts* of ROC, article 1.

mandates (authorizes) his/her property rights to the trustee. The term “trust” is “信托 (*xintuo*)” in Chinese. It means “to mandate somebody to deal with something on the basis of trusting in him/her”. Thus, the reason why the creator mandates his/her property rights to the trustee is that he/she has confidence in the trustee.

Thirdly, the trustee shall administer or dispose of the trust property according to the will (request) of the creator. He/she should respect and not violate the will of the creator of the trust. In addition, the trustee shall administer or dispose of the trust property in his/her own name rather than in the creator’s or other person’s name.

Fourthly, the trustee shall administer or dispose of the trust property for the interest of the beneficiary or for other specific purpose or purposes, such as a charitable purpose, demanded by the creator. He cannot administer or dispose of the trust property for his/her own benefit.

Compared with the definitions of trust given by other Civil Law jurisdictions, the definition of trust given by the Chinese *Law of Trusts* is special in three closely related respects. First, the settlor/testator creates the trust “on the basis of trusting the trustee”. Secondly, the Law adopts the term “mandates” rather than the term “transfers” to provide for the transfer of the trust property from the creator to the trustee. Thirdly, the definition emphasises that the trustee shall administer and dispose of the trust property in his/her own name. These three characteristics render the definition the most controversial one in Chinese legal circles in relation to the Chinese *Law of Trusts*.

As stated above, since the term “trust” [信托 (*xintuo*)] means, in Chinese, to mandate something to someone on the basis of trusting in him/her, it is redundant to add the phrase “on the basis of trusting a trustee” in article 2 of the Chinese *Law of Trusts*.

The term “mandate”, which has been adopted by article 2 of the Chinese *Law of Trusts*, means “委托 (*weituō*)” in Chinese. “*Weituō*” means “authorize” in Chinese, and it denotes the concept of agency. When the law of trusts was drafted, the trust was unfortunately fundamentally mistaken for an institution which is similar to agency. For example, in the Sixteenth Session of the Standing Committee of the Chinese NPC on June 29, 2000, the Law Committee of the Chinese NPC presented the *Report on Revising the Draft of the Chinese Law of Trusts* which expressly stated that “to accept the mandate of a person and to manage the property for the person is the basic characteristic of the trust. According to the statement, article 2 of the Second Draft of the Chinese Law of Trusts provides: “The trust within the meaning of this Law signifies the juristic act under which a creator, on the basis of trusting a trustee, mandates his/her property rights to the trustee who, according to the will of the creator, administers or disposes of the property in his/her own name for the interest of the beneficiary or for other specific purpose”.

This definition was criticised by some scholars as well as some drafters during the International Seminar of the Enactment of the Chinese *Law of Trusts* presided over by the Law Committee of the Chinese NPC held in Beijing on October 31 and November 1, 2000. In the seminar, Fei Zhongyi, a former Chief Justice of the Civil Juristic Division of the Chinese People’s Supreme Court, said that “to transfer the title of the property to the trustee is a prerequisite for the creation of a trust”.<sup>18</sup> He also said that the definition not only confused the trust with agency, but also contradicted article 13 of the Law (Draft), which provides “the property acquired by the trustee by virtue of accepting the trust is

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<sup>18</sup> . Materials of the International Seminar of the Enactment of the Chinese *Law of Trusts*.

trust property”.<sup>19</sup> Thus, he suggested that “mandates” in the definition should be replaced by “transfers”.

Likewise, Wei Yaorong, a former Director of the Economic Law Department of the Law Committee of the Chinese NPC, said that the reason why the definition provided that the creator “mandates” rather than “transfers” his/her property to the trustee might be based on the view that the trustee should not enjoy the ownership of the trust property. If the law provided that the creator transferred his/her property to the trustee, it meant that the trustee would have the ownership of the trust property. So, the trustee could exclude the supervision of the creator and would abuse the rights of a trustee. He also thought that the property should be transferred to the trustee, because it is a prerequisite for a trustee to manage and dispose of the property. However, he said, “to provide that the creator transfers his/her property to the trustee does not mean that the trustee has the complete ownership of the trust property, because the law at the same time also provides that the trustee only enjoys the right to manage and the right of disposal, not the right to benefit”.<sup>20</sup>

On the contrary, Bian Yaowu, the Vice Director of the Legal Committee of the Standing Committee of the Chinese NPC, proposed his four elements of the trust in the International Seminar. First, he said, the trust is a system of managing property. Second, the trust means accepting the mandate of a person and to manage the property for the person. Third, the greatest benefit of a trust is that the creator did not need to manage the property by himself/herself. Last, the constitution of trust property is the result of its creator authorising the trustee to exercise some of his/her properties. These rights

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<sup>19</sup> . Article 13 of the Second Draft of the Chinese Law of Trusts was re-enacted as article 14 of the Chinese *Law of Trusts*.

<sup>20</sup> . Materials of the International Seminar of the Enactment of the Chinese *Law of Trusts*.

included the right to use, the right to manage and the right of disposal.<sup>21</sup> In fact, Bian still regards a trust as a kind of agency.

As shown above, the concept of duality of ownership under the Common Law does not exist in the Chinese legal system and the common law concept violates the principle of “one right to one thing” of the Chinese property law. Thus, in the International Seminar, the scholars suggested that China should not accept the structure of the duality of ownership and the trustee should acquire limited, rather than complete, ownership.<sup>22</sup> They also suggested that when giving the definition of a trust, the Chinese *Law of Trusts* would, on the basis of foreign legislative experiences and the Chinese special circumstances, select a phrase (wording) which is both suitable for the Chinese legal tradition and suitable for the method of habitual expression, so as to define the trust reasonably and to let the trust function optimally.

However, when the Third Draft of the Chinese Law of Trusts was submitted for examination in the Twenty-First Session of the Standing Committee of the Chinese NPC in April, 2001, the definition of the trust given by the Second Draft of the Law was not changed and remained as article 2 of the Third Draft of the Law. In the morning of April 25, 2001 when the Standing Committee examined the Third Draft of the Chinese Law of Trusts, Professor Wang Liming, also a member of the Economy Committee of the Chinese NPC, again suggested that the trust relationship should be distinguished from the agency, so the phrase “the creator mandates his/her property rights to the trustee” in the definition should be revised to read “the creator transfers his/her property rights to the trustee”. But, his suggestion was rejected. Article 2 of the Chinese *Law of Trusts* does not

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<sup>21</sup> . Ibid.

<sup>22</sup> . The Summary of the International Seminar of the Chinese *Law of Trusts*.

adopt the term “transfer” or “vest” to express the transfer of the trust property from the creator to the trustee.

It is thought that there may be two reasons as to why the Chinese *Law of Trusts* does not use the term “transfer” to replace the term “mandate”. One is that “transfer” usually means the transfer of the ownership of a property, but a trustee cannot acquire the complete ownership of the property because he/she cannot enjoy the right to the benefit of the property. Maybe the drafters thought that the term “transfer” would result in the confusion that what the trustee acquired was the complete ownership of the property. The other is that there is no equivalent in Chinese to the phrase “the trustee holds the property on trust” or the phrase “the property is held on trust”. Thus, the adoption of the term “mandate” is really a hard-choice. However, although the use of the term “mandate” avoids the confusion that the trustee is the absolute owner of the trust property,<sup>23</sup> it confuses a trust with an agency by adopting the term “mandate”.

To distinguish a trust from an agency, the definition of trust has to emphasize that the trustee does not administer or dispose of the trust property in the name of the creator like an agent does, but in the trustee’s own name. But the emphasis does not avoid the confusion of a trust with an agency. Under an undisclosed agency, such as a commission agency provided for by the article 414 of the Chinese *Contract Law*, the agent also engages in a business in his/her own name. Therefore, merely to add that “the trustee administers or disposes of the property in his/her own name” is not sufficient to distinguish a trust from an agency.

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<sup>23</sup> . A trustee’s ownership is a quasi-ownership because he/she has to exercise his/her such ownership for the benefit of the beneficiary. A trustee’s ownership under the Chinese *Law of Trusts* will be discussed in section 1.2.2.1.1 “the segmentation of ownership” of this thesis.

Although article 2 of the Chinese *Law of Trusts* uses the term “mandate” rather than the term “transfer” or “vest” to describe the transfer of the trust property from the creator to the trustee, and although a trust was mistaken as an institution similar to agency, when the Chinese *Law of Trusts* was enacted, it is safe to say that the term “mandate” in article 2 of the *Law* means “transfer” in the Common Law sense. First, all the arguments on whether the Chinese *Law of Trusts* should use the term “mandate” or the term “transfer” are based on how to distinguish a trust from an agency rather than on whether a trust is or is not an agency. It is clear from the legislative purpose of the Chinese *Law of Trusts* that a trust is not an agency; otherwise there would have been no need for China to enact a law of trusts.

Secondly, although the phrase “the trustee administers or disposes of the property in his/her own name” alone is not sufficient to distinguish a trust from an agency, the legislative purpose of the phrase is to draw a firm line between a trust and an agency.

Thirdly, according to article 32 of the *Law*, the co-trustees shall assume the joint and several liabilities to a third party in relation to the administration of the trust. Similarly, a trustee shall bear liability to a third party in respect of the conduct of trust affairs. To bear liability means a trustee can be sued or sue in a court. To make a trustee bear liability independently, the title of the trust property must be vested in the trustee. As some of the experts, such as Fei Zhongyi, Wei Yaorong, and Wan Liming, said above, the transfer of the property from the creator to the trustee is a prerequisite of the creation of a trust. Without the transfer of the trust property, the trustee can neither exercise his/her rights nor perform his/her duties.

Fourthly, the references to the transfer of the trust property can be found in some other articles of the Chinese *Law of Trusts*. For example, article 14 of the *Law* provides that “the trust property means property acquired by a trustee by virtue of accepting the trust”. The term “acquired” here means the acquisition by way of transfer not by way of authorization. Also, article 16 of the *Law* provides that “trust property is distinct from the trustee’s own property”. If the title of the trust property has not been transferred to the trustee, it would not have needed to distinguish the trust property from his/her individual property. Again, article 10 (1) of the *Law* provides that “where the trust property is required to be registered by relevant laws or administrative regulations, it must be registered”. In the Civil Law jurisdictions, the transfer of the title to land will not be valid or against the third party unless the transfer has been registered according to relevant laws or administrative regulations.<sup>24</sup> If there was no transfer, there would not be the requirement of the registration because the title of the property did not transfer to the trustee.

By virtue of the deficiency in the definition of the trust given by article 2 of the Chinese *Law of Trusts*, it is suggested that it should be better for the Law to define the trust as “the ‘trust’ within the meaning of this law shall signify that a settlor or a testator/testatrix vests his/her property rights in the trustee who administers or dispose of the property rights for the interest of the beneficiary or for other specific purpose or purposes” authorized by law.

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<sup>24</sup> . The German *Civil Code*, article 873 and 877; the *Civil Code* of ROC, article 758; The Swiss *Civil Code*, article 656; the Japanese *Civil Code*, article 177.

## 1. 2 Characteristics of Trusts

### 1.2.1 Characteristics of Trusts under the Common Law

#### 1.2.1.1 *Paramountcy of the trust*

The trust is the most important institution developed within the exclusive jurisdiction of equity, which can be described as that body of law developed by the Court of Chancery prior to 1873<sup>25</sup> and owes its development to the Lord Chancellors of England.

The common law, which existed before equity and emerged in the twelfth century, was a complete and independent legal system that could function without equity. However, the common law was both deficient and rigid in some respects, because in the courts of common law, causes of action were based precisely on the writs. “If a cause of action did not fall within the scope of a proper original writ, no relief could be given.”<sup>26</sup> “Thus, if someone suffered a wrong which was not recognized as such by an existing form of writ, then the person so wronged had no right to sue the wrongdoer in a court of common law”<sup>27</sup>.

According to Maitland,<sup>28</sup> from the thirteenth century, petitions were addressed to the King by persons who were not satisfied with the common law, seeking remedies outside the common law. By the end of thirteenth century, such petitions presented in each year were very large, so in practice, a great number of the petitions were addressed to the Lord Chancellor. The Lord Chancellor, who was “the King’s secretary of state for all departments”, “usually a bishop”, and the head of the Chancery and later the Court of

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<sup>25</sup> . Meagher, Gummow and Lehane: *Equity – Doctrines and Remedies* (1992, 3<sup>rd</sup> ed), para [101].

<sup>26</sup> . Scott and Fratcher: *The Law of Trusts* (1987, 4<sup>th</sup> ed), Volume I, §1.4.

<sup>27</sup> . Denis S.K. Ong: *Trusts Law in Australia* (2003, 2<sup>nd</sup> ed), p 1.

<sup>28</sup> . Maitland: *Equity* (1936), pp 3 – 4.

Chancery,<sup>29</sup> would act on the conscience of individuals when the common law procedure was considered unconscionable. He would issue an injunction against an individual to stop the enforcement of a common law judgment or prevent the bringing of an action or to prevent a remedy being awarded by a common law court.<sup>30</sup> Gradually, following the increasing number of petitions to the Lord Chancellor, the equitable jurisdiction was formed.

In 1615, the issue of a common injunction against a common law plaintiff by the Lord Chancellor Ellesmere in *Earl of Oxford's case*<sup>31</sup> precipitated a dispute between Coke LCJ of the Court of King's Bench and Ellesmere LC. Coke LCJ "believed that it would lead to anarchy if the chancellor were permitted to enjoin a judgment creditor from enforcing his judgment", and Ellesmere LC, "on the other hand, contended that he was not attempting to interfere with the courts of law but was merely punishing a plaintiff who unconscientiously insisted on relying upon his legal rights".<sup>32</sup> In 1616, the dispute was referred to King James I who resolved the dispute in favour of the Lord Chancellor. "The King decided that the chancellor was right and should be permitted to go ahead and issue his decrees and injunctions."<sup>33</sup> From then on, the rules of equity have prevailed over the rules of common law whenever they conflicted.

Since the trust is enforced in the exclusive jurisdiction of equity, where there is a conflict between trust and other legal institutions, the trust shall prevail. For example, where a debtor goes bankrupt, the common law position is that all his/her properties shall be listed as liquidation properties and divisible among the creditors. However, if a trustee

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<sup>29</sup> . Ibid, p 2.

<sup>30</sup> . Ibid, p 9.

<sup>31</sup> . (1615) 1 Ch Rep 1; 21 ER 485.

<sup>32</sup> . Scott and Fratcher: *The Law of Trusts* (1987, 4<sup>th</sup> ed), Volume I, §1.

<sup>33</sup> . Ibid.

becomes bankrupt, the equitable position is that the trust property held by the trustee should not be listed as liquidation properties and should not be paid to creditors of the trustee.

### **1.2.1.2 Separation of the legal and equitable ownership**

The most important characteristic of a trust is the separation of the legal ownership and equitable ownership as between the trustee and the beneficiary. As discussed above, because the common law was both deficient and rigid in some respects, it did not recognize the concept of trust and regarded the owner of property as the holder of common law title. However, equity recognized the trust concept and would enforce the trust in favour of the beneficiary against the trustee.

In the light of the maxim of equity, “equity follows the law”, the enforcement of a trust does not simply deny the legal rights of the trustee but compels him/her perform his/her obligations for the benefit of the beneficiary. Thus, in enforcing a trust by a Lord Chancellor, “although the chancellor did not and could not directly destroy or alter the legal rights of the parties, he could bring powerful pressure upon the parties to compel them to yield their rights”.<sup>34</sup> The enforcement of a trust established the separation of the equitable ownership from the legal ownership.

The establishment of the separation of the equitable and legal ownership results in the separation of the liabilities and rights between the trustee and the beneficiary. As far as the trustee is concerned, the trustee, no matter whether he/she is paid or unpaid, is under an overarching duty of care and assumes, with respect to administering the trust property, the risks and liabilities to third parties or to the beneficiary where there is a breach of

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<sup>34</sup> . Scott and Fratcher: *The Law of Trusts* (1987, 4<sup>th</sup> ed), Volume I, §1.

duty; whilst the beneficiary is entitled to enjoy all the beneficial interests of the trust property without undertaking any risk and liabilities with respect to the administration of the trust property by the trustee.

The characteristic, the separation of the legal and the equitable ownership, is the quintessence of a trust and other characteristics of the trust are derivations of this characteristic.

### **1.2.1.3 Severance characteristic of the trust property**

The trust property is the core element of a trust. There cannot be a trust without trust property. Nevertheless, the core of the trust property is its severance characteristic, namely, the severance of the equitable title from the legal title. The severance characteristic of trust property lies in three aspects.

#### **1.2.1.3.1 The severance characteristic with respect to the trust parties**

First, the absolute ownership of the trust property is severed from the trust parties. Under a trust, none of the trust parties has the absolute title to the trust property. Although the trustee holds the legal title and controls the trust property, he/she cannot make the use of the trust property for his/her own benefit. He/She is compelled in equity to hold the title for the benefit of the beneficiary and he/she is only a nominal owner of the trust property.

Again, the beneficiary is the true (substantive) owner of the trust property, however, he/she has only the equitable title of the trust property and he/she does not control the trust property. It is a principle that although the beneficiaries of a trust who are all *sui juris* and who are absolutely entitled to the trust property are entitled to terminate the

trust unanimously, they cannot direct the trustees of the trust as to the execution of the trust so long as they choose to keep the trust alive.<sup>35</sup>

In respect of a settlor, after a trust is validly created, he/she is neither an equitable owner nor a legal owner of the trust property, except where he/she also happens to be the trustee or one of the trustees who have the legal title, or where he/she is the beneficiary or one of the beneficiaries who have the equitable title. However, the settlor can exercise the rights, which he/she reserved in the trust instrument, as to the trust property.

### **1.2.1.3.2 The severance characteristic with respect to third parties**

Secondly, the trust property is severed from third parties, namely, it is beyond the claims of the creditors of the settlor and the trustee. After a trust is created, the settlor is not the owner of the trust property. So, the creditors of the settlor cannot claim the reimbursement of the debts from the trust property. In respect of the trustee, although the trustee holds the legal title of the trust property, he/she holds the legal title for the benefit of the beneficiary. The trustee is not the true owner, so the creditors of the trustee cannot claim the trust property too. Even if the trustee goes bankrupt, the trust property cannot be listed as liquidation property to be distributed among the creditors of the trustee.<sup>36</sup>

However, because the beneficiary has the beneficial interests in the trust property, he/she is the true owner of the trust property. Therefore, the creditors of the beneficiary can claim against the beneficiary's interest, they cannot claim against the legal title of the trust property.

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<sup>35</sup> . *Re Brockbank* [1948] 1 Ch 206.

<sup>36</sup> . *Bankruptcy Act* 1966 (Cth), s 116 (2) (a).

### **1.2.1.3.3 The severance characteristic with respect to other properties**

Thirdly, the trust property is severed from other properties. One of the trustee's duties is to keep the trust property vested in him/her separately and not to mix it with his/her own properties by keeping proper accounts.<sup>37</sup> Where a person is a trustee of several trusts, he/she must exercise the duty of care with respect to each one of such trusts separately and cannot mix the different trust properties of different trusts together. In addition, the properties that the trustee acquires in the course of administering and managing the trust estates still belongs to the trust estates, such as the rent the trustee acquires by renting a house, or the money acquired by selling the house. The newly acquired trust property shall be also separated from the property of other trusts, and from the trustee's own property.

### **1.2.1.4 Elasticity of trust**

Maitland said the trust "is an 'institute' of great elasticity and generality; as elastic, as general as contract".<sup>38</sup> The elasticity of the trust is embodied in the various purposes of the trusts, the versatile methods of creating a trust, the extensive range of the trust property.

#### **1.2.1.4.1 The elasticity of the trust purposes**

In respect of the various purposes of the trusts, Scott said: "The purposes for which trusts can be created are as unlimited as the imagination of lawyers. There are no

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<sup>37</sup> . Meagher and Gummow: *Jacobs' Law of Trusts in Australia* (1997, 6<sup>th</sup> ed), para 1713.

<sup>38</sup> . F. W. Maitland: *Equity* (1936), p 23.

technical rules restricting the creation of trusts. The trust can be and has been applied as a device for accomplishing many different purposes.”<sup>39</sup>

First of all, a trust can be created for family settlements. For example, a settlor, who has no time and has no special knowledge of managing a huge sum of money efficiently, may vest the money to a professional trustee to administer the trust property for his/her family. A settlor may also make a long-term “gift” plan by transferring assets to a trustee for the benefit of his/her young children, and directing the trustee to transfer the relevant part of the trust property to each child when he/she reaches the age of 20 years. Again, a settlor may create a trust to divide the beneficial interest among several beneficiaries, such as that one of the beneficiaries enjoys the income of the trust property, while the other beneficiaries enjoy the remainder after the death of the beneficiary who enjoys income. In addition, a person may create a discretionary and a protective trust to protect the beneficiaries in the enjoyment of their interests by making those interests inalienable and putting them beyond the reach of the creditors of the beneficiaries. Moreover, a trust may be employed to avoid taxation.

Apart from family settlements, a trust may be created for a charitable purpose. A trust may be created for the relief of the poverty, for the advancement of the religion or education, or for the purpose beneficial to the community.

In addition, a trust may be created for a business purpose. Entering the twentieth century, the employment of trusts in commercial areas has become more and more important. “It will be seen that well over 90% of the money held in trust in the United States is in commercial trusts as opposed to personal trusts.”<sup>40</sup> The typical business trust

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<sup>39</sup> . Scott and Fratcher: *The Law of Trusts* (1987, 4<sup>th</sup> ed), Volume I, §1.

<sup>40</sup> . John H. Langbein: *The Secret Life of the Trust: the Trust as An Instrument of Commerce* (1997) 107 Yale L.J. 165.

is the unit trust, “in which the managers receive money from investors, and form a single fund, divided up into units which are owned by the investors. The management is paid expenses and salary.”<sup>41</sup> In the United States, there is a counterpart of a unit trust, the mutual fund. Under the mutual fund, an investment company that raises money by selling its own stock to the public and investing the proceeds in other securities, with the value of its stock fluctuating with its experience with the securities in its portfolio.<sup>42</sup>

The trading trust is another kind of trust engages in business. A trading trust arises where a trustee is expressly given the power to carry on a business. In the United States, an equivalent device of trading trust is the corporate trustee which was praised by Scott as “the great contribution made by America to the development of the trust”.<sup>43</sup> According to Scott, the corporate trustees are trust companies and banks that are conferred on trust powers to administer trusts.<sup>44</sup> The trustees of the trading trusts can be individuals as well as companies, but the corporate trustees only refer to trust companies or banks. In the United States, there are more other kinds of commercial trusts, such as pension trust, regulatory compliance trust, and remedial trust.<sup>45</sup>

Furthermore, a trust even can be validly created for political reasons. In the United States and Canada, there is a kind of trusts, the “blind trust”, created for political reasons. According to *Duhaime’s Law Dictionary*, the blind trust is “a trust set up by a settlor who reserves the right to terminate the trust but other than that, agrees to assert no power over the trust, which is administered without account to the beneficiary/settlor or the retention

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<sup>41</sup> . Jill E. Martin: *Modern Equity* (1997, 15<sup>th</sup> ed), p 516. In the *Jacobs’ Law of Trusts in Australia*, it is not the single fund that is divided up into units, but it is the trust property the manger purchases and vests in the trustee that is divided into units. See Meagher and Gummow: *Jacobs’ Law of Trusts in Australia* (1997, 6<sup>th</sup> ed), para 313.

<sup>42</sup> . Henry C. Black: *Black’s Law Dictionary* (1979, 5<sup>th</sup> ed), p 920.

<sup>43</sup> . Scott and Fratcher: *The Law of Trusts* (1987, 4<sup>th</sup> ed), Volume I, §1.8.

<sup>44</sup> . Ibid.

<sup>45</sup> . John H. Langbein: *The Secret Life of the Trust: The Trust as an Instrument of Commerce* (1997) 107 Yale L. J. 165.

of any other measure of control over the trust's administration. In Canada, for example, it is common for government ministers to vest all their investment property to a blind trust to avoid any conflict of interest".<sup>46</sup> However, the blind trust has not been imported into Australia,<sup>47</sup> nor does it exist in England.

#### 1.2.1.4.2 The versatile methods of creating a trust

A trust can be created by various methods. It may be created *inter vivos* as well as created by will. The settlor may create a trust by transferring the trust property to the trustee or trustees, or may create the trust without transferring the trust property by simply declaring himself/herself as the trustee.

Apart from trusts which are created by the express intention of the settlor or testator/testatrix, a trust may be created by the operation of law, such as a constructive trust, which is imposed "simply on the principle that an individual shall not be benefited by his own personal fraud".<sup>48</sup>

In addition, a trust may be created by the presumption of the implied intention of the creator, such as the resulting trust which sometimes is also called an implied trust.<sup>49</sup>

Moreover, a trust may be also created directly by the provisions of statutes, such as a statutory trust.<sup>50</sup> Under the *Law of Property Act 1925* of the United Kingdom, a statutory trust, a trust for sale was imposed on the two forms of co-ownership, namely the joint tenancy<sup>51</sup> and the tenancy in common<sup>52</sup>. Again, under the *Administration of Estates Act*

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<sup>46</sup> . *Duhaime's Law Dictionary* can be retrieved on: <http://www.duhaime.org/dictionary/dict-b.htm#B>.

<sup>47</sup> . Meagher and Gummow: *Jacobs' Law of Trusts in Australia* (1997, 6<sup>th</sup> ed), para 320.

<sup>48</sup> . *McCormick v Grogan* (1869) LR 4 HL 82 at 97.

<sup>49</sup> . *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669 at 703 (per Lord Browne-Wilkinson).

<sup>50</sup> . Scott and Fratcher: *The Law of Trusts* (1987, 4<sup>th</sup> ed), Volume I, §17. 5.

<sup>51</sup> . *Law of Property Act 1925*, s 36.

<sup>52</sup> . *Ibid.* s 34.

1925 of the United Kingdom, a personal representative is sometimes treated as a trustee.<sup>53</sup>

#### 1.2.1.4.3 The extensive range of the trust property

The assets which can be made the subject matter of a trust are of almost unlimited compass. “All property, real or personal, legal or equitable, at home or abroad, and whether in possession or action, remainder or reversion, and whether vested or contingent, may be made the subject of a trust, unless (a) the policy of the law or some statutory enactment has made it inalienable; or (b) where the property is land abroad the trusts sought to be created are inconsistent with the *lex loci situs*.”<sup>54</sup>

It is easy to understand that a tangible asset can be made the subject matter of a trust, such as a house. Sometimes, however, it is somewhat difficult to understand that the equitable interest, the chose in action, and the shares of a company, can be made subject matter of a trust.

In respect of an equitable interest, it can be made as the subject matter of a trust “where the title vested in the trustee is an equitable interest which is *not* a beneficial interest under a trust, a *trust* of that equitable interest will be created”.<sup>55</sup>

Also, a constituted trust of a chose in action is enforceable. In Australia, all the states provide that a chose in action may be assigned. In the light of the *Property Law Act 1974* (Qld), an entire common law chose in action must be assigned under section 199, and an entire equitable chose in action can be assigned under or outside section 199.<sup>56</sup> Except for

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<sup>53</sup> . *Administration of Estates Act 1925*, s 33.

<sup>54</sup> . Underhill and Hayton: *Law Relating to Trusts and Trustees* (1987, 14<sup>th</sup> ed), p 133.

<sup>55</sup> . Denis Ong: *Trusts Law in Australia* (2003, 2<sup>nd</sup> ed), p 4. (Emphasis added by the author).

<sup>56</sup> . *Federal Commissioner of Taxation v Everett* (1980) 143 CLR 440.

Western Australia,<sup>57</sup> parts of common law and equitable choses in action can only be assigned in equity. A gift of part of a common law chose in action has effect as the assignment of an equitable chose in action.

According to *Colonial Bank v Whinney*,<sup>58</sup> although company shares are choses in action, they are not assignable under section 199 of the *Property Law Act 1974* (Qld) and its counterparts in other jurisdictions. Section 1070 A (1) and (3) of the *Australian Corporations Act 2001* (Cth) provides that subject to the company's constitution, an equitable interest in a share may be created, dealt with and enforced in the same way as other personal property. However, section 1071 B (2) of the *Corporations Act* provides that "a company must only register a transfer of securities if a proper instrument of transfer has been delivered to the company". In the UK, the legal title to the company shares is transferable by the execution of the form of transfer required by the company's articles, followed by registration in the share register of the company.<sup>59</sup>

In addition, an expectancy, or a mere possibility, or a future property, which means something that is not existing presently, cannot be made subject matter of a trust. Windeyer J said, "As it is impossible for anyone to own something that does not exist, it is impossible for anyone to make a present gift of such a thing to another person, however sure he may be that it will come into existence and will then be his to give"<sup>60</sup>. However, if such expectancy is conveyed for the valuable consideration, the expectancy will, in equity, vest immediately in the covenantee who has given the valuable consideration to the covenantor, who has promised to assign the expectancy, as soon as it

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<sup>57</sup> . *Property Law Act 1969* (WA), s 20 (3).

<sup>58</sup> . (1886) 11 App. Cas. 426.

<sup>59</sup> . *Companies Act 1985* (UK), ss 182, 183.

<sup>60</sup> . *Norman v Federal Commissioner of Taxation* (1963) 109 CLR 9, at 24

comes into existence.<sup>61</sup> Nevertheless, it is noteworthy that the future property should not be confused with the right to the future property, because the right to the future property is the present property.<sup>62</sup>

### **1.2.1.5 Continuity of trust**

The continuity is the unique characteristic of a trust. In order for a trust to be created, it must satisfy three certainties, namely certainty of intention; certainty of subject matter; and certainty of objects. However, although the trustee is the essential element of a trust, no certainty of trustee is required. It is the non-requirement of the certainty of the trustee that makes the trust unique. The continuity of the trust is embodied in the following elements.

#### **1.2.1.5.1 The continuance of a trust despite “want of a trustee”**

First, it is a principle of equity that a trust will not be allowed to fail for want of a trustee.<sup>63</sup> Any trust must have a trustee or trustees. That is one of the essential elements of a trust. Generally, any person who is able to hold property on trust may be a trustee. A trustee may be appointed by the settlor in the trust instrument, or by the testator/testatrix in the will creating the trust. A settlor even may declare himself as the trustee. However, where a settlor or a testator/testatrix has negligently not appointed a trustee to carry out the trust, or the trustee whom he/she has chosen is dead, the trust will not fail. Rather, the court will appoint trustees to carry out the trust.<sup>64</sup> Also, where the trustee appointed by

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<sup>61</sup> . *In re Lind* [1915] 2 Ch 345 at 360 (per Swinfen Eady LJ).

<sup>62</sup> . *Williams v Commissioner of Inland Revenue* [1965] NZLR 395; *Shepherd v Federal Commissioner of Taxation* (1965) 113 CLR 385.

<sup>63</sup> . *Mallott v Wilson* [1903] 2 Ch 494; [1900-3] All ER Rep 326.

<sup>64</sup> . *A-G v Stephens* (1834) 3 My & K 347 at 352, 40 ER 132 at 134; *Dodkin v Brunt* (1868) LR 6 Eq 580 at 581.

the settlor or the testator/testatrix disclaims the trust, the trust will not be at an end and a new trustee or new trustees will be appointed, “save in the rare cases where the settlor or testator has himself made the validity of the trust dependent upon the acceptance of office by particular trustees”<sup>65</sup>.

### **1.2.1.5.2 The replacement of the new trustee**

A trust will not yet be terminated because of the replacement of the trustees. In respect of some of legal institutions, such as agency, an agency will be terminated by virtue of the agent’s death or lack of capacity, while a trust will continue after the undesired trustees are replaced by the new trustees. The new trustee will continue to carry out the trust. In the United Kingdom, section 36 (1) and (2) of the *Trustee Act 1925* provide for the statutory power of appointing new trustees. In Australia, all States<sup>66</sup> provide for the replacement of original or substituted trustees, and all States<sup>67</sup> empower the court to appoint a new trustee or new trustees in substitution for, or in addition to, any existing trustee and to appoint a trustee even where there is no existing trustee.

### **1.2.1.5.3 The application of the *cy-pres* doctrine**

In addition, the continuity of the trust embodies in the application of the doctrine of *cy-pres*, namely the doctrine of as nearly as possible to the specified purpose, of charitable trusts. The *cy-pres* application arises where a purported trust to promote a specific charitable purpose cannot be executed precisely in the way intended by the creator of the trust, or because the creator’s directions cannot exhaust the trust fund, or

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<sup>65</sup> . Jill E. Martin: *Modern Equity* (1997, 15<sup>th</sup> ed), p 492.

<sup>66</sup> . *Trusts Act 1973* (Qld), s 12; *Trustee Act 1962* (WA), s 7; *Trustee Act 1958* (Vic), s 41 and 42; *Trustee Act 1936* (SA), s 14 and 14B; *Trustee Act 1925* (NSW), s 6; *Trustee Act 1898* (Tas), s 13.

<sup>67</sup> . *Trusts Act 1973* (Qld), s 80; *Trustee Act 1962* (WA), s 77; *Trustee Act 1958* (Vic), s 48 and 49; *Trustee Act 1936* (SA), s 36; *Trustee Act 1925* (NSW), s 70; *Trustee Act 1898* (Tas), s 32.

that the creator's donations to charitable purpose are insufficient to execute the purpose, the court applies the purported trust, the unexhausted trust fund, or the insufficient donations, to other charitable purposes which are as near as possible to those intended by the creator of the trust.

#### ***1.2.1.6 Concealment of trust***

The possibility of concealing both the name of the creator or the beneficiary is another feature of the trust. A settlor or a testator/testatrix can achieve the aim of concealment of either the owner of the beneficial interests or the name of the creator through the device of trust. For example, if a father wants to transfer 10,000 shares in a company to his daughter, but he does not want to let his daughter's ownership of the shares to be publicly known, he can achieve this by transferring the shares to a trustee on trust for his daughter. After the shares are transferred, they will be registered by the company in the name of the trustee, but his daughter is entitled to receive the dividends and any other benefits derived from those shares.

Apart from the general trusts, which have the characteristic of concealment, some special trusts, namely the fully-secret trust and the half-secret trust are employed particularly to achieve the aim of concealment. A fully-secret trust arises where a testator leaves property by his will to a trusted person absolutely, but he/she, while alive, has informed that person that the property is to be held on specified trusts, and that person accepts the trust. While a half-secret trust arises where a testator leaves property to a trusted person with a direction in the will that it is to be held on trust, and details of the

trust are not contained in the will but have been communicated to the trusted person before or at the time of the making of the will.<sup>68</sup>

Under a fully-secret trust, the will of the testator/testatrix does not disclose that there is any trust existing; while under a half-secret trust, although a trust is revealed by the will, the beneficiaries or the terms of the trust are not known to public. The characteristic of concealment is completely embodied in the two kinds of secret trusts.

It is said that a secret trust was often used historically by a testator to provide for his mistresses or illegitimate children. “Today it is more likely that a secret trust will be used by the indecisive rather than secretive testator”.<sup>69</sup>

## **1.2.2 Characteristics of trusts under the Civil Law**

### ***1.2.2.1. The common characteristics of trusts under the Chinese Law of Trusts***

Since the Chinese *Law of Trusts* borrows the basic principles from the trusts law under the Common Law, it, undoubtedly, possesses characteristics which are the same as or similar to those of the trusts law under the Common Law.

#### **1.2.2.1.1 The segmentation of ownership**

Like the duality of ownership under the Common Law, the segmentation of ownership is also the most important characteristic of a trust under the Civil Law.

Under the Civil Law, because there is no division of equitable and legal ownership, there is no double ownership or duality of ownership. As discussed above,<sup>70</sup> ownership

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<sup>68</sup> . Moffat, Bean, Dewar, and Milner: *Trusts Law – Text and Materials* (1999, 3<sup>rd</sup> ed), p 113.

<sup>69</sup> . Ibid, p 114.

refers to sole ownership. The concept of ownership denotes complete or absolute ownership. It means that an owner of a thing has the absolute right, within the limitation of law, to dominate the thing freely and to exclude others from interfering with it. According to article 71 of the Chinese GPCL, ownership is a complete and overall right which consists of four dominative incidental rights: the right to possess, the right to use, the right to benefit, and the right of disposal. The right of disposal is regarded as the paramount indicium of ownership, because it decides the fate of a property. Usually, an owner will lose ownership if he/she loses the right of disposal. For example, the owner of a thing may lose ownership of the thing by selling it to another person. Although he may borrow the thing from the new owner to possess and to use the thing, he cannot dispose of the thing again.

After a trust is created, the absolute ownership of the trust property is divided between the trustee and the beneficiary. The trustee enjoys three out of the four dominative incidental rights of ownership, namely the right to possess, the right to use, and the right of disposal, while the beneficiary enjoys the right to benefit. Because the trustee is entitled to dispose of the trust property and he/she can deal with the trust property in the way that an owner does, he/she, according to the property law under the Civil Law, has the ownership of the trust property. However, although the trustee can dispose of the trust property, he/she does not have the absolute ownership of the trust property because he/she cannot enjoy the right to benefit. Actually, the trustee's ownership is a kind of quasi-ownership, and the quasi-ownership can be also named as trustee's ownership in order to distinguish it from other absolute ownership under the Civil Law.

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<sup>70</sup> . See section 1.1.2 “the Definition of the Trust under the Civil Law” of this thesis.

The beneficiary enjoys the right to the benefit, but the beneficiary is not limited only to the right to benefit. In certain circumstances, a beneficiary has the right to decide the ultimate fate of the trust property. For example, if a sole beneficiary is also the settlor, he/she can terminate the trust. Article 50 of the Chinese *Law of Trusts* provides:<sup>71</sup>

Where the settlor is the sole beneficiary, the settlor or his or her heirs may at any time revoke the trust except that it is otherwise provided by the trust instrument.

Given that a beneficiary can terminate a trust in certain circumstances, the beneficiary also has the right to dispose of the trust property because he/she can decide the ultimate fate of the trust property and ask the transfer of the trust property from the trustee to himself/herself. Thus, the beneficiary is also the owner of the trust property. The ownership of the beneficiary can be directly called beneficiary's ownership in order to respond to the trustee's ownership.

Like the term "mandate" which means "transfer" in the Common Law sense,<sup>72</sup> the segmentation of ownership under the Civil Law is actually the duality of ownership in the Common Law sense. Because there is the division of equitable and legal ownership under the Common Law, it is logical to adopt the phrase "duality of ownership". However, because there is no the division of equitable ownership and legal ownership under the Civil Law, it is more pertinent to adopt the phrase "segmentation of ownership". The phrase of segmentation of ownership is in conformity with habitual Chinese legal expression.

The "segmentation of ownership" of a trust supplements and develops the traditional Chinese theory of property rights. On the one hand, it breaks through the limitation of the

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<sup>71</sup> . See also the Japanese *Law of Trusts*, article 57; the South Korean *Law of Trusts*, article 56; the *Law of Trusts* of ROC, article 63.

<sup>72</sup> . Refer to section 2.1.2.2 "The definition of the trust given by the Chinese Law of Trusts" of this thesis.

principle of “one right to one thing” because both the trustee and the beneficiary have the right to dispose of the trust property; on the other hand, it is, in essence, not inconsistency with the principle of “one right to one thing” because the trustee’s ownership and the beneficiary’s ownership are not two separate absolute ownerships.

The reason why the principle of “one right to one thing” requires that there cannot be two ownerships of the same thing is that otherwise there will be an irreconcilable conflict when the different owners exercise their rights of ownership. Their ownerships are independent and not subject to each other. However, the segmentation of ownership in a trust is quite different. Although both the trustee and the beneficiary enjoy the right to dispose of the trust property, there will not be any conflict when they exercise their right of disposal respectively. First, the trustee is not the true owner of the trust property because he/she cannot enjoy the benefits of the trust, and, most importantly, his/her right to dispose of the trust property is limited, in nature, to dispose of the trust property for the benefit of the beneficiary. In fact, the right of disposal enjoyed by a trustee is not a “right”, but a duty which is imposed on him/her to exercise the right properly so as to let the beneficiary or beneficiaries enjoy the benefit of the trust.

Secondly, the trustee’s ownership is subject to the beneficiary’s ownership. The beneficiary is entitled to decide the ultimate fate of the trust property by terminating the trust. Where the sole beneficiary who is also the settlor decides to terminate the trust,<sup>73</sup> the trustee’s right of disposal is subject to the beneficiary’s right to terminate the trust. If the settlor is not the sole beneficiary, the settlor can terminate the trust with the consent of the beneficiary.<sup>74</sup> In addition, either the settlor or the beneficiary can dismiss the

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<sup>73</sup>. The Chinese *Law of Trusts*, article 50.

<sup>74</sup>. *Ibid*, article 51 (1) (c).

trustee under the terms of the trust instrument or apply to the court to dismiss the trustee if the trustee disposes of the trust property in violation of the purpose of the trust, or manages or disposes of the trust property with gross negligence.<sup>75</sup> Moreover, apart from that the trustee shall keep the complete record of conducting trust affairs and apprise the settlor and the beneficiary of the management and disposal of the trust property and the revenue and expenditure regularly once a year,<sup>76</sup> the settlor and the beneficiary have the right to know the revenue and the expenditure, the management and the disposal of the trust property, and to demand the explanation of the trustee as to the conduct of the trust affairs.<sup>77</sup>

Thirdly, although the beneficiary can terminate the trust in certain circumstances, he/she cannot direct the trustee how to exercise the right of disposal. Otherwise, the trustee's right of disposal will be interfered with. If the trustee has inflicted losses upon trust property through mismanagement, or disposal of the trust property in violation of the duty of a trustee, either the settlor or the beneficiary can apply the court to rescind the act of the trustee and demand that the trustee indemnify losses or restore the trust property.<sup>78</sup> However, either the settlor or the beneficiary cannot direct the trust how to exercise the right of disposal if they do not elect to terminate the trust.

So far there is no complete and coherent property law in China and the legal provisions (totalling thirteen articles) concerning property are still those which were stipulated in the Chinese GPCL in 1987. In 1994, the Chinese legislative body added property law into its legislative plan and hoped to enact a Chinese property law at the time of the enactment of the Chinese *Contract Law*, so as to meet the needs of a rapidly

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<sup>75</sup>. Ibid, article 23 and 49 (1).

<sup>76</sup>. Ibid, article 33.

<sup>77</sup>. Ibid, article 20 (2).

<sup>78</sup>. The Chinese *Law of Trusts*, article 22 (1) and 49 (1).

developing Chinese economy. Later, the decision was taken to enact a Chinese civil code, and in March, 1998, the legislative body decided to engage a group of legal experts to draft the Chinese civil code. Thus, no property law was introduced when the Chinese *Contract Law* was enacted in 1999. On December 23, 2002, the Draft of the Chinese Civil Code was referred to the Thirty-First Session of the Standing Committee of the Ninth National People's Congress for examination. Because there were many controversies surrounding the Draft Civil Code, it was rejected and there has not been a second draft of the Chinese Civil Code so far.

The segmentation of ownership is a contribution of the Chinese *Law of Trusts* to the traditional Chinese theory of ownership. It will certainly revolutionize the law in the future Chinese Civil Code.

#### **1.2.2.1.2 Other Common Characteristics**

Apart from the characteristic of the segmentation of ownership, there are some other characteristics under the Chinese *Law of Trusts* which are similar to those of trusts law under the Common Law. First of all, the Chinese *Law of Trusts* provides for the distinct and separate existence of trust property.

To ensure that a trust can function optimally, article 15 of the Chinese *Law of Trusts* first provides that “the trust property shall be set apart from other properties owned by the settlor/testator”, and then, article 16 provides that “the trust property is distinct from trustee's own property and it shall not appertain to the trustee's own property or part of trustee's own property”. The two articles prevent the creditors of the settlor and the trustee from claiming the trust property. Again, to secure the separate existence of the trust property from the trustee's own property, the Chinese *Law of Trusts* also provides

that the trustee shall keep separate accounts of the trust property and his/her own property as well as keep separate accounts of the trust properties of different settlors/testators.<sup>79</sup>

Secondly, the Chinese *Law of Trusts* provides for the characteristic of the elasticity of trusts. The settlor/testator can create a trust for various purposes, such as family settlements, business and charitable purposes, so long as these purposes are not illegal or against public policy.<sup>80</sup> In addition, the assets which can be made the subject matter of a trust are very extensive. All the lawful assets, including the legal rights of property, can be made the subject matter of the trust property.<sup>81</sup> However, the methods of creating a trust under the Chinese *Law of Trusts* are not as elastic as those provided for by the trusts law under the Common Law.<sup>82</sup>

In addition, the characteristic of the continuity of trust is stipulated in the Chinese *Law of Trusts*. Article 13 of the *Law* provides: “Where a trustee appointed by the will refuses to take the office as a trustee or has no capability to be a trustee, a new trustee can be selected by the beneficiary or by the guardian of the beneficiary”. Also, after the creation of a trust, a trustee may resign from his/her office with the consent of the settlor and the beneficiary. In this case, the trust will not fail and the trustee who has resigned shall continue to conduct the trust affairs until the new trustee is selected.<sup>83</sup> Again, in the course of performing his/her duty, the office of a trustee will be terminated in certain circumstances.<sup>84</sup> Where the office of a trustee is terminated by virtue of the aforesaid circumstances, the new trustee shall be selected in accordance with the provisions of the

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<sup>79</sup> . The Chinese *Law of Trusts*, article 29.

<sup>80</sup> . Ibid, article 3, 5 and 6.

<sup>81</sup> . Ibid, article 7.

<sup>82</sup> . The methods of creating a trust provided for by the Chinese *Law of Trusts* will be discussed in detail in section 6.1.1.1 of this Thesis.

<sup>83</sup> . Ibid, article 38.

<sup>84</sup> . Ibid, article 39.

trust instrument, or selected by the settlor, the beneficiary or the guardian of the beneficiary.<sup>85</sup> Moreover, the characteristic of the continuity of trust provided for by the Chinese *Law of Trusts* lies in the cy-près doctrine. Where the purported charitable purpose of a trust cannot be carried out, the trustee, with the approval of the administrative office, shall apply the property, under the cy-près doctrine, to other charitable purpose or purposes which are as near as possible to the failed purported purpose.<sup>86</sup>

Lastly, the purpose of concealment of the name of the settlor/testator or the beneficiary can be also achieved under the Chinese *Law of Trusts*.

However, in the light of that the Chinese *Law of Trusts* is a mixture of trusts law under the Common Law jurisdiction and the Chinese civil law, the trust under the Chinese *Law of Trusts* possesses distinctive characteristics.

### **1.2.2.2 The Distinctive Characteristics of Trusts under the Chinese Law of Trusts**

#### **1.2.2.2.1 The strict writing requirements of creating a trust**

Although the trusts laws under the Civil Law jurisdictions usually limit the creation of a trust to two methods, namely by contract and by will,<sup>87</sup> a trust can be created effectively by an oral contract or will so long as the constitution of the trust meets the requirements of the contract law and the succession law.

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<sup>85</sup> . Ibid, article 40.

<sup>86</sup> . Ibid, article 72.

<sup>87</sup> . The Japanese *Law of Trusts*, article 2; the South Korean *Law of Trusts*, article 2; the *Law of Trusts* of ROC, article 2; the Quebec *Civil Code*, article 1262.

However, the Chinese *Law of Trusts* prescribes stricter requirements, the writing requirements of creating a trust. Article 8 (1) of the Chinese *Law of Trusts* explicitly provides that a trust can only be created in writing. The written formalities of creating a trust include contract, will or other written instruments.<sup>88</sup> Where a trust is created by a contract, the trust shall be created when the contract is signed by the trust parties; where a trust is created by other written documents, the trust shall be created when the trustee accepts the trust;<sup>89</sup> where the trust is created by a will, the trust shall be created when the will becomes effective according to the succession law.

Trust is a new legal institution in China and is not known to most of the Chinese people, so it seems that it is in conformity with the Chinese practice to provide for strict writing requirements for creating a trust. But it should consider whether it is necessary for every trust to be created in writing, especially those trusts under which the value of trust assets are not great, and whether the strict requirement should be relaxed after the trust institution is developed to a high level in China.

#### **1.2.2.2 Increasing the rights of the settlor**

Under the Common Law, the trust proffers the settlor a platform on which he/she can exercise his/her freedom. The settlor has the freedom to dispose of trust property for various purposes; he/she has the freedom to select the beneficiary and allot the proportion of beneficial interests between the beneficiaries; and he/she can reserve rights in the trust instrument. However, as soon as a trust is created, the settlor cannot deal with the trust property except that he/she has reserved such rights in the trust instruments. The trust

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<sup>88</sup> . The Chinese *Law of Trusts*, article 8 (1).

<sup>89</sup> . Ibid, article 8 (3).

relationship only exists between the trustee and the beneficiary, and the settlor is not a party to the trust.

However, the trusts laws under the Civil Law have changed the legal status of the settlor. Under the Civil Law, because a trust *inter vivos* is created by a contract, a settlor is not only a party to the trust contract, but also a party to the trust relationship. The settlor enjoys many rights after the trust has been created, such as the right to demand that the trustee change the method of administering the trust property;<sup>90</sup> the right to inspect, note down, copy trust accounts of trust property and other documents relative to the conduct of the trust affairs;<sup>91</sup> and the right to appoint new trustees.<sup>92</sup>

Except for the aforesaid rights,<sup>93</sup> the Chinese *Law of Trusts* also provides that a settlor has other rights after a trust is created. For example, under certain circumstances after the trust is created, the settlor may change the beneficiary and vary or dispose of the beneficial interests of the beneficiary.<sup>94</sup>

The reason why the Chinese *Law of Trusts* increases the rights of a settlor is that it respects the rights and intention of the settlor more than the rights of the beneficiary. In the definition of the trust, the *Law* provides that the trustee administers or disposes of the trust property for the beneficial interests of the beneficiary “according to the will of the settlor/testator”.<sup>95</sup>

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<sup>90</sup> . The Japanese *Law of Trusts*, article 23; the South Korean *Law of Trusts*, article 36 (1); the *Law of Trusts* of ROC, article 16.

<sup>91</sup> . The Japanese *Law of Trusts*, article 40 (2); the South Korean *Law of Trusts*, article 34; the *Law of Trusts* of ROC, article 32 (1).

<sup>92</sup> . The *Law of Trusts* of ROC, article 36 (3).

<sup>93</sup> . The Chinese *Law of Trusts*, article 19 to 23.

<sup>94</sup> . *Ibid*, article 51.

<sup>95</sup> . *Ibid*, article 2.

### 1.2.2.2.3 The mono-form of trust

The trust is generally classified into three categories in the Common Law countries, namely express trusts, resulting trusts and constructive trusts. Express trusts are created by the express intention of the creator, while the latter two trusts are created either by the implied intention of the settlor or by the operation of law.

However, in the Civil Law countries, trusts are usually created by the express intentions of the trust parties because they are mainly created by contract and will. Although article 1262 of the Quebec *Civil Code* also provides that a trust may be established, “in certain cases, by operation of law”, Chapter II, Title Six of the *Civil Code*, which deals with trust, does not explain what the certain cases are.

Following the trusts laws of Japan, South Korea, Taiwan and Quebec, the Chinese *Law of Trusts* only provides for the express trusts which can be divided into trusts *inter vivos* and the testamentary trusts. There are two considerations for China to provide for mono-form of the trust. One is that the legal system of the trust is an absolutely new system to China. It is useful to absorb the legislative experiences of other Civil Law jurisdictions. Since Japan, South Korea and Taiwan do not provide for the trusts created by the operation of law, China does not need to stipulate them. The other consideration is that the trust is defined as a kind of lawful act and one of the requirements of a lawful act is the intention of the parties, so it is better to provide for express trust only.

## 1.3 Comparison between Trust and Other Similar Concepts

Under both the Common Law and the Civil Law, there are some legal concepts which are related to a trust. However, some concepts which are often compared with a trust under the Common Law do not have their counterparts under the Civil Law, such as the fiduciary relationship, equitable charge or equitable lien, and powers. This thesis only compares a trust with those legal concepts which are similar to a trust and which exist both under the Common Law and the Civil Law.

### 1.3.1 Trust and Debt

#### 1.3.1.1 *Trust and debt under the Common Law*

Although debt is an everyday word in human life, it is not easy to define it satisfactorily. Ong's definition of debt may be the most complete one. He states:<sup>96</sup>

At common law a debt based on a loan is an obligation that arises whenever the title to a sum of money is transferred absolutely by one person (the creditor) to another person (the debtor) such that the debtor is bound, either on demand by the creditor or on a date agreed to between the creditor and the debtor, to transfer absolutely to the creditor or to a person or persons nominated by the creditor, either a sum identical to the sum initially transferred by the creditor to the debtor or such sum plus another sum (being the interest on the loan) payable for the use of the money by the debtor between the date of the commencement of the loan and the date of its repayment.

Conceptually, the distinction between a trust and a debt is clear, however, sometimes it is difficult to distinguish a transaction which creates a debt from a transaction which

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<sup>96</sup> . Denis Ong: *Trusts Law in Australia* (2003, 2<sup>nd</sup> ed), p 7.

creates a trust. There are three elements which determine whether a relationship is a debt or a trust. The first element is the common intention of the parties of the relationship. In *Cohen v Cohen*,<sup>97</sup> Dixon J quoted approvingly the judgment of Channell J in *Henry v Hammond*,<sup>98</sup> where the latter stated:

It is clear that if the terms upon which the person receives the money are that he is bound to keep it separate, either in a bank or elsewhere, and to have that money so kept as a separate fund to the person entitled to it, then he is a trustee of that money and must hand it over to the person who is his cestui que trust. If, on the other hand, he is not bound to keep the money separated, but is entitled to mix it with his own money and deal with it as he pleases, and when called upon to hand over an equivalent sum of money, then, in my opinion, he is not a trustee ... but a mere debtor.

Section 12 (g) of the *Restatement of Trusts 2d* provides that the manifestation of intention is the decisive element to determine whether a transaction is a debt or not. It provides:

If one person pays money to another, it depends upon the manifested intention of the parties whether a trust or a debt is created. If the intention is that the money shall be kept or used as a separated fund for the benefit of the payor or a third person, a trust is created. If the intention is that the person receiving the money shall have the unrestricted use thereof, being liable to pay a similar amount whether with or without interest to the payor or to a third person, a debt is created.

In addition, Scott suggested that “where the language of the parties does not clearly show their intention, all the circumstances must be considered in order to determine whether a debt or a trust was intended”.<sup>99</sup>

The other two elements, which can be used to determine whether a relationship is a trust or a debt, lie in the nature of a trust and a debt. Under a trust, “there is a fiduciary

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<sup>97</sup> . (1929) 42 CLR 91.

<sup>98</sup> . [1913] 2 K B. 515, at 521.

<sup>99</sup> . Scott and Fratcher: *The Law of Trusts* (1987 4<sup>th</sup> ed), §12.2.

relationship between trustee and beneficiary but not between debtor and creditor as such".<sup>100</sup> Thus, if there is a fiduciary relationship between the parties, it is a trust; if there is no fiduciary relationship between the parties, it is merely a debt.

Similarly, given that a beneficiary has an equitable interest in the trust property, while the creditor has only a personal claim against his debtor,<sup>101</sup> the third element to determine whether a relationship is a trust or a debt lies in whether the payee or a third person has an equitable interest in the money. If the payee or a third person has an equitable interest in the money, it is a trust. On the contrary, if the payee or a third person has no equitable interest in the money, but a mere personal claim against the payor, it is a debt.

The distinction between a trust and a debt is of great importance in practice. In the case of bankruptcy, if a debtor becomes bankrupt and his assets are insufficient to pay his debts in full, according to section 108 of the *Bankruptcy Act* 1966 (Cth), his creditors will only be able to claim from his assets a ratable proportion of what is owed to them by the debtor. Whilst, if a trustee becomes bankrupt, by virtue of section 116 (2) (a) of the *Bankruptcy Act*, the trust property is not divisible among the trustee's creditors and the beneficiary is entitled to it.

In addition, because a beneficiary is the equitable owner of the trust property, he/she can trace the property to a third person who is not the bona fide purchaser for value of the legal estate without notice if the trustee transfers the trust property to the person in breach of the trust. On the other hand, a creditor is not entitled to trace his/her money because he/she has only a personal claim against the debtor.

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<sup>100</sup> . Ibid, §12.1.

<sup>101</sup> . Ibid.

Moreover, in the case where money is lost by accident, if a debtor lost the money, the debt itself is not affected and the debtor still bears the obligation to pay the creditor. On the other hand, if the trust property is lost or destroyed by accident without any fault of the trustee, “the loss falls upon the beneficiary and not upon the trustee”.<sup>102</sup>

### **1.3.1.2 Trust and debt under the Civil Law**

The term “debt” means “*zhai*” in Chinese, however, the legal term used to signify “*zhai*” in Chinese is “obligation” which derived from the Latin substantive “*obligatio*”. Article 84 (1) of the Chinese GPCL gives a definition of debt by providing:

An obligation refers to a specific relationship of rights and obligations (duties) established between the parties concerned, either according to the agreed terms of a contract or legal provisions. The party entitled to the rights shall be the obligee, and the party assuming the obligations shall be the obligor.

Under the Civil Law, an obligation may arise by virtue of contract or by operation of law, such as tort, unjust enrichment or management without mandate. In spite of what causes the creation of an obligation, the contents of the obligation are the obligatory rights of the obligee, namely the act of the obligee to claim performance from the obligor, and the obligatory duties of the obligor, namely, the act of the obligor to fulfil his/her duty in response of the obligee’s claim. Article 241 of the German *Civil Code*, which is titled as “content of obligation”, provides: “The effect of an obligation is that the obligee is entitled to claim performance from the obligor.” Article 84 (2) of the Chinese GPCL provides: “The obligee shall have the right to demand that the obligor fulfil his/her obligations as specified by the contract or by the provisions of law”.

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<sup>102</sup> . Ibid.

Under the Civil Law, in many cases the parties to the contracts are obligees as well as obligors in that they enjoy and assume obligatory rights and duties mutually. For example, in a contract of sale of a car, the seller has the duty to deliver the car to the buyer and is entitled to claim the payment from the buyer. The seller is the obligee who is entitled to claim the payment as well as the obligor who is under the duty to deliver the car. *Vice versa*, the buyer is also the obligee who is entitled to claim the seller to deliver the car as well as the obligor who is under the duty to pay the purchase money.

Because of the different ways of creating an obligation, the subject matter differs between the obligations and the performance of the obligor may differ from delivering a thing, paying a sum of money, or performing an act. The term “debt” under the Common Law is, conceptually, not exactly the same as the term “obligation” under the Civil Law in that the subject matter of a debt under the Common Law only refers to money, while it includes things, money and acts under the Civil Law. The range of obligation under the Civil Law is broader than that under the Common Law. The term “debt” under the Common Law is only one of obligations similar to “money obligation” under the Civil Law. However, the term “debt”, “creditor” and “debtor” are often used to supplant the term “obligation”, “obligee” and “obligor” when the legal concept “*zhai*”(obligation) is translated into English. The reason for translating “obligation” into “debt” may be merely for convenience, because no exact concept of “obligation” under the Civil Law can be found under the Common Law.

In China, the distinction between a debt and a trust is clear. Generally, it is not difficult to determine whether the parties of a relationship intend to create a trust or a debt. In the light of articles 6, 8, and 9 of the Chinese *Law of Trusts*, the creation of a trust

must be in writing and the trust purpose shall be clearly stated in the written instrument which creates the trust.

However, distinguishing a trust from a debt is also important in practice in China. First, according to article 16 (2) of the Chinese *Law of Trusts*, “where a trustee dies, is dissolved, is disbanded by law, or is declared bankrupt, the trust property shall not appertain to his/her legacy or property in liquidation”. Thus, the beneficial interests of a beneficiary shall not be prejudiced by the death, dissolution or bankruptcy of the trustee.

Secondly, article 22 (1) of the Chinese *Law of Trusts* provides:

Where a trustee has inflicted losses upon trust property through mismanagement or disposal of the trust property in violation of the duty of a trustee, the settlor has the right to apply to the court to rescind the act of the trustee and demand of the trustee the indemnification of losses or the restitution of trust property. Where the transferee has known that he/she has received the trust property in violation of the purpose of the trust, he/she shall return the trust property that he/she has already received or indemnify the losses.

From the first sentence of article 22 (1), it can be presumed that the trustee shall not assume the liability for the loss of the trust property so long as the loss is caused without his/her fault.

Thirdly, according to the second sentence of the above article, it can also be deduced that the beneficiary can demand from the third person the return of the trust property if the third person is not a bona fide purchaser.

Therefore, it is clear that compared with a creditor of a debt, the beneficiary of a trust in China is effectively given more protection.

## 1.3.2 Trust and Contract

### 1.3.2.1 *Trust and contract under the Common Law*

Generally, a trust and a contract differ in the following aspects. A trust is a concept of equity, while a contract is a concept at common law. A trust is always a fiduciary relationship, while a fiduciary relationship only exists in some contracts, such as a contract between a principal and an agent. A trust creates proprietary rights in the beneficiary, while the rights of the parties to a contract are only personal rights. A trust arises from the intention of the creator or by operation of law, while a contract arises only from the agreement of the contracting parties. Mostly, a trust is created gratuitously, while a contract requires the consideration between the parties to make the contract valid unless the contract is made by deed. A beneficiary of a trust can sue the trustee for breach of the trust, while by virtue of the rule of privity of contract, a third-party beneficiary to a contract cannot, at common law, sue the contract parties to perform the contract. The settlor of trust cannot revoke or vary the trust by agreement or otherwise unless he/she reserves a power of revocation and variation in the trust instrument, while the parties to a contract can revoke or vary the contract according to the terms expressed in the contract or by new agreement.

Nevertheless, a trust and a contract are not exclusive. An express trust can be created by a contract either with sufficient considerations or by deed. In *Barclays Bank Ltd v Quistclose Investment Ltd*,<sup>103</sup> it was held a loan contract was entered into to create a trust.

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<sup>103</sup> . [1970] AC 567.

There, Lord Wilberforce analysed the loan agreement between Rolls and Quisclose, saying:<sup>104</sup>

The mutual intention of the respondents [Quisclose] and of Rolls Razor Ltd, and the essence of the bargain, was that the sum advanced should not become part of the assets of Rolls Razor Ltd, but should be used exclusively for payment of a particular class of its creditors, namely, those entitled to the dividend. A necessary consequence from this, by process simply of interpretation, must be that if, for any reason, the dividend could not be paid, the money was to be returned to the respondents: the word “only” or “exclusively” can have no other meaning or effect.

That arrangement of this character for the payment of a person’s creditors by a third person, give rise to a relationship of a fiduciary character or trust, in favour, as a primary trust, of the creditors, and secondarily, if the primary trusts fails, of the third person, has been recognised in a series of cases over some 150 years.

It is clear that a trust is distinct from a contract. However, it is not so easy to distinguish a trust from a contract for the benefit of a third party since a trust is a device created for the benefit of a third party. With respect to how to distinguish a trust from a contract for the benefit of a third party, Scott thought that “whether there is a trust or merely a contract for the benefit of a third party depends on whether there is property held by one person for the benefit of the third party, or merely a personal undertaking to make payment to the third party”.<sup>105</sup>

In Australia, the distinction between a trust and a contract is based on the intentions of the parties. In *Trident General Insurance Co. Ltd. v McNiece Bros. Pty. Ltd.*,<sup>106</sup> Mason C.J. and Wilson J said:<sup>107</sup>

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<sup>104</sup> . Ibid, at 580.

<sup>105</sup> . Scott and Freatcher: *The Law of Trusts* (1987, 4<sup>th</sup> ed), §14.

<sup>106</sup> . (1988) 165 CLR 107.

<sup>107</sup> . Ibid, at 121.

We are speaking of express trusts, the existence of which depends on intention. In divining intention from the language which the parties have employed the courts may look to the nature of the transaction and the circumstances, including commercial necessity, in order to infer or impute intention.

In the United States “it is immaterial whether a trust is created or a contract is made for the benefit of a third party”, because “the beneficiary of a contract, as well as the beneficiary of a trust, has rights that he can enforce”.<sup>108</sup>

In England and Australia, it is sometimes important to distinguish a trust from a contract for the benefit of a third party by virtue of the doctrine of privity of contract, according to which, the third party of a contract cannot enforce the contract in that he/she is not a party to the contract.<sup>109</sup>

However, the doctrine of privity of contract has been modified or revised by case law and legislation in Australia and it has been abolished in England. In Australia, in *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd*,<sup>110</sup> it was held that a third party may sue the insurer on a liability insurance policy issued by the insurer even though he/she is not a contracting party and not providing consideration. Toohey J said:<sup>111</sup>

The proposition which I consider this Court should now indorse may be formulated along these lines. When an insurer issues a liability insurance policy, identifying the assured in terms that evidence an intention on the part of both insurer and assured that the policy will indemnify as well those with whom the assured contracts for the purpose of the venture covered by the policy, and it is reasonable to expect that such a contractor may order its affairs by reference to the existence of the policy, the contractor may sue the insurer on the policy, notwithstanding that consideration

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<sup>108</sup> . Scott and Fretcher: *The Law of Trusts* (1987, 4<sup>th</sup> ed), §14.3.

<sup>109</sup> . *Midland Silicones Ltd v Scruttons Ltd* [1962] AC 446; *Woodar Investment Development Ltd v Wimpey Construction UK Ltd* [1980] 1 All ER 571; *Wilson v Darling Island Stevedoring and Lighterage Co Ltd* (1956) 95 CLR 43.

<sup>110</sup> . (1988) 165 CLR 107.

<sup>111</sup> . *Ibid*, at 172.

may not have moved from the contractor to the insurer and notwithstanding that the contractor is not a party to the contract between the insurer and assured.

Apart from case law, the legislation also modified and revised the doctrine of privity of contract in Australia. The typical legislation includes section 13, section 15, and section 55 of the *Property Law Act 1974* (Qld).

In England, *Contracts (Rights of Third Parties) Act 1999* abolished the doctrine of privity of contract. Section 1 (1) of the *Act* provides:

Subject to the provisions of this Act, a person who is not a party to a contract (a “third party”) may in his own right enforce a term of the contract if-

- (a) the contract expressly provides that he may, or
- (b) subject to subsection (2), the term purports to confer a benefit on him.

Also, section 2 (1) of the *Act* further provides:

Subject to the provisions of this section, where a third party has a right under Section 1 to enforce a term of the contract, the parties to the contract may not, by agreement, rescind the contract, or vary it in such a way as to extinguish or alter his entitlement under that right, without his consent if-

- (a) the third party has communicated his assent to the term to the promisor,
- (b) the promisor is aware that the third party has relied on the term, or
- (c) the promisor can reasonable be expected to have foreseen that the third party would rely on the term and the third party has in fact relied on it.

### **1.3.2.2 Trust and contract under the Civil Law**

Since contract is the main method to create a trust in the Civil Law countries, any contract which creates a trust shall be regarded as a trust contract. A trust contract under

the Civil Law is governed by two legal principles, namely the law of trusts and the law of contracts. Thus, before the discussion of the distinction between a trust and a trust contract, it is necessary to distinguish a trust contract and other contracts under the Civil Law.

### **1.3.2.2.1. The trust contract and other contracts**

As one kind of contract under the Civil Law, a trust contract has similarities to other contracts<sup>112</sup>. First, it must be lawful. A contract is regarded as a juristic act, so a trust contract must be created lawfully. Secondly, the parties to the trust contract must have the civil capacity to enter into the contract. Thirdly, the intention to create the trust of the contracting parties shall be genuine. Lastly, the parties to the trust contract shall express their intention in accordance with the requirements of the formality.

The distinction between a trust contract and other contracts lies in the following aspects. The first and the most important distinction is the intention of the parties. If the parties to a contract intend to enter into a contract for the purpose of creating a trust, the contract is a trust contract. All the civil codes and contract laws of Civil Law countries provide that contract parties shall express their intention of entering a contract genuinely.<sup>113</sup> That means where the parties enter into a trust contract, they shall have the intention to create a trust. Apart from the fact that the Chinese GPCL and the Chinese *Contract Law* provide that the declaration of intention of the contracting parties shall be genuine, article 9 (1) (a) of the Chinese *Law of Trusts* specifically provides that with regard to the creation of a trust, the written instrument shall clearly state the purpose or purposes of the trust.

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<sup>112</sup> . The Chinese GPCL, article 55, 56; the Chinese *Contract Law*, article 9, 10, 13.

<sup>113</sup> . See the Japanese *Civil Code*, from article 93 to 96; the *Civil Code* of ROC, from article 86 to 89.

In addition, a trust contract is governed both by trusts law and contract law. With respect to a trust contract, the relationship between trusts law and contract law is the relationship between a specific law and a general law. Except that a trust contract shall be governed by contract law in relation to the establishment and the basic principles of a contract, all the other contents of the trust contract shall be governed by the law of trusts, such as the nature of a trust; the powers, duties, and rights of a trustee; the rights of a beneficiary and a settlor; the variation and termination of a trust; and charitable trusts.

Moreover, most of the contracts only concern two parties, while a trust contract concerns three parties. Although the beneficiary is not one of the contracting parties, the contracting parties enter into the trust contract for the benefit of the beneficiary.

Furthermore, the right of the beneficiary is of the characteristic of a right *in rem* as well as a right *in personam*, while the rights of the contracting parties or the third beneficiaries of contracts other than trust contract are only rights *in personam*.

#### **1.3.2.2 The trust contract and the contract for the benefit of a third party**

Since a trust contract is entered into for the benefit of the beneficiary, it is similar to a contract for the benefit of a third party, such as an insurance contract. The first similarity they share is that the beneficiaries both in a trust contract and in a contract for the benefit of a third party are non-contracting parties, but the purpose of entering into the either kind of contract is for the benefit of the non-contracting party.

The second similarity is that under the Civil Law both the beneficiary of a trust contract and of a contract for the benefit of a third party can enforce the contract. Under

the Civil Law, there also exists the rule of privity of contract. A judgment issued by the Japanese Supreme Court on 17<sup>th</sup> Feb., 1909 stated: “It is a rule that a contract is binding only upon the parties and not upon third persons: therefore no third person can demand performance direct from the debtor except in virtue of such special provisions as those of Article 537 of the Civil Code”.<sup>114</sup> However, a third party can enforce a contract so long as the contract is entered for the benefit of him/her and he/she declares to accept the benefit. Article 537 of the Japanese *Civil Code*<sup>115</sup> provides:

- (1) Where a party to a contract has agreed therein to effect an act or performance in favour of a third person, such third person is entitled to demand such act of performance directly to the obligor.
- (2) In the case mentioned in the preceding paragraph, the right of the third person shall come into existence as from the time when he declares to the obligor his intention to accept the benefit of the contract.

Although a trust contract is similar to a contract for the benefit of a third party, the distinction between them is still clear. First, their intention and purpose are different. A trust contract is entered into for creating a trust, while the purpose of a contract for the benefit of a third party is to benefit the third party without creating a trust for him/her.

Secondly, a settlor may be the sole beneficiary and in this case, there are only two parties to the trust contract, while a contract for the benefit of a third party must have a third person and a contracting party cannot be the third person. Although the applicant, the insured and the beneficiary of an insurance contract can be the same person, just like that a settlor can be the sole beneficiary in a trust contract, it is not a contract for the benefit of a third party, but a contract for the benefit of the applicant himself/herself.

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<sup>114</sup> . Cited from J. E. de Becker: *The Principles and Practice of the Civil Code of Japan* (reprinted edition, 1979), volume 1, p 365.

<sup>115</sup> . See also the *Civil Code* of ROC, article 269.

Thirdly, although there is no concept of fiduciary relationship in the Civil Law, there is a fiduciary-like relationship between a trustee and a beneficiary in a trust, because the trustee is under a duty of loyalty to the beneficiary. However, there is no such fiduciary-like relationship between a contracting party and the non-contracting third party beneficiary of a contract for the benefit of a third party.

Fourthly, the conditions of revocation and variation of the contracts are different. Generally, after a trust contract is entered into and the trust is effective, the settlor cannot revoke or vary the trust. However, if he/she reserves the right of revocation or variation in the terms of the trust contract, he/she can revoke or vary the trust no matter whether the beneficiary expresses the intention to accept the trust or not. Whilst, the contracting parties to a contract for the benefit of a third party can revoke or vary the contracts before the third party beneficiary declares to accept the benefit of the contract. However, as soon as the third party beneficiary declares to accept the benefit of the contract, the contracting parties cannot revoke or vary the contract. For example, article 538 of the Japanese *Civil Code* provides:<sup>116</sup>

After the right of the third person has come into existence in accordance with the provision of the preceding Article, the parties cannot effect its alteration or its extinction.

Article 269 (2) of the *Civil Code* of ROC has the same provision by stipulating in a reverse way:

So long as the third person has not declared his intention to take advantage of the contract specified in the preceding paragraph, the parties may modify the contract or cancel it.

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<sup>116</sup> . Article 537 of the Japanese *Civil Code* provides: “(1) Where a party to a contract has agree therein to effect an act or performance in favour of a third person, such third person is entitled to demand such act of performance directly to the obligor. (2) In the case mentioned in the preceding paragraph, the right of the third person shall come into existence as from the time when he declares to the obligor his intention to accept the benefit of the contract”.

In China, the legal provisions for the contract for the benefit of the third party are, to some extent, different from those of other Civil Law jurisdictions. The Chinese *Contract Law* emphasizes the doctrine of privity of contract by providing: “A contract concluded in accordance with the law is legally binding on the parties”.<sup>117</sup> Thus, with respect to a contract for the benefit of a third party, the *Law* only recognizes the promisor’s liability to the promisee if the promisor failed to perform to the third party. Article 64 of the Chinese *Contract Law* provides:

Where the parties agree that the debtor shall perform the obligation to a third party, and if the debtor fails to perform the obligation to the third party or if his performance is not in conformity with the agreement, the debtor shall be liable to the creditor for the breach of contract.

The above article of the Chinese *Contract Law*, in fact, denies that a third party has a right to demand performance from the promisor directly or to claim damages against the promisor. Some scholars or commentators, including those from the Supreme People’s Court of China, consider that the third party has the right directly to demand the debtor’s performance.<sup>118</sup> They thought that since the third party’s right stems from the agreement, it is unnecessary for the law to provide for it. If the third party could not enforce the contract, article 64 of the Chinese *Contract Law* would be meaningless.<sup>119</sup> However, this view does not correctly reflect the legislative purpose of the *Law*. First, the agreement between the creditor and the debtor itself cannot create the right to sue the debtor for

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<sup>117</sup> . The Chinese *Contract Law*, article 8 (1).

<sup>118</sup> . Hu Kangsheng (ed): *Commentary on the Chinese Law of Contract* (1999), p 113; Jiang Ping (ed): *A Concise Commentary on the Chinese Law of Contract* (1999), p 54; Xiao Xun (ed): *Commentary on the Chinese Law of Contract* (1999), p 238-239; Economic Division of the Supreme People’s Court: *Interpretation and Application of the Chinese Law of Contract* (1999), p 283.

<sup>119</sup> . Economic Division of the Supreme People’s Court: *Interpretation and Application of the Chinese Law of Contract* (1999), p 283.

breach of the contract, except where the agreement is recognized by law.<sup>120</sup> The right to bring an action can only be created by law rather than by the agreement. Therefore, it is wrong to say that it is not necessary for the law to provide for the third party's right to enforce the contract since the debtor has agreed to perform the contract to the third party.

Secondly, the reason why the General Provisions of the Chinese *Contract Law* do not provide that a third party beneficiary can enforce the contract is that the third party beneficiary's rights are provided for in the Specific Provisions of the *Law* or have been provided for by other specific laws. For example, Chapter 14 (from article 237 to article 250) of the Chinese *Contract Law* deals with the Financial Leasing Contracts,<sup>121</sup> and article 239 of the *Law*<sup>122</sup> provides:

Where the lessor concludes a contract of sale according to the lessee's selection of the seller and the leased thing, the seller shall deliver the subject matter to the lessee according to the agreement, and the lessee shall have the rights of a buyer in respect of the subject matter he accepts.

Again, article 240 of the *Law* provides:

The lessor, the seller and the lessee may agree that if the seller fails to perform his/her obligation under the contract of sale, the claim for compensation shall be exercised by the lessee. If the lessee exercises the claim for compensation, the lessor shall provide assistance.

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<sup>120</sup> . With respect to a financial leasing contract, Article 240 of the Chinese *Law of Contract* provides that "the lessor, the seller and the lessee may agree that the lessee can claim for the compensation if the seller fails to perform his/her obligation under the contract of sale".

<sup>121</sup> . According to article 237 of the Chinese *Law of Contract*, "a financial leasing contract is a contract whereby the lessor, according to the lessee's selection of the seller and the subject matter, buys the leased thing and provides it to the lessee for his/her use, and the lessee pays rent".

<sup>122</sup> . See also articles 309, 340 and 341 of the Chinese *Contract Law* which deal the right of a consignee of a contract of carriage to demand the delivery of the goods by the carrier and the right of the consignee to claim damages against the carrier for damage or loss of the goods.

Apart from the Specific Provisions of the *Chinese Contract Law*, other specific laws also provided for the third party beneficiary's rights. For example, article 21 (3) of the *Chinese Insurance Law* provides:<sup>123</sup>

A beneficiary with respect to the insurance of persons means that person who is designated by the insured or the applicant, and is entitled to claim for the insurance benefits. The applicant or the insured may be the beneficiary.

Therefore, in China, with respect to a contract for the benefit of a third party, the third party cannot enforce the contract,<sup>124</sup> except where it is otherwise provided by the *Chinese Contract Law* or by other specific laws.

As stated earlier, in other Civil Law countries, so long as the third party declares the intention to accept the benefit of the contract, the contracting parties cannot revoke and vary the contract.<sup>125</sup> However, the case in China is converse. The Chinese laws pays much attention to the rights of contracting parties rather than those of a non-contracting third party, because it was thought that the rights of the third party stems from the agreement of the contracting parties. Thus, in China, the contracting parties to a contract for the benefit of a third party can revoke or vary the contract even after the third party has declared his/her intention to accept the benefit. Article 14 of the *Chinese Insurance Law* provides:

Unless otherwise provided herein, or in the insurance contract, the applicant may revoke the contract after it is concluded.

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<sup>123</sup> . See also the *Chinese Maritime Law*, article 42 (4) and 78 (1); the *Chinese Civil Aviation Law*, article 120; the *Chinese Railway Law*, article 16 (2).

<sup>124</sup> . The *Chinese Contract Law*, article 64.

<sup>125</sup> . The *Japanese Civil Code*, article 538; the *Civil Code* of ROC, article 269 (2).

In addition, article 20 of this *Law* provides that: “during the period of the validity of the insurance contract, the applicant and the insurer may agree to vary the insurance contract”.

Moreover, article 308 of the Chinese *Contract Law* provides:

Before the carrier delivers the goods to the consignee, the consignor may request the carrier to suspend the carriage, return the goods, change the place of destination or deliver the goods to another consignee, but the consignor shall compensate for any loss sustained by the carrier as a result thereof.

### **1.3.2.2.3 Trust and trust contract**

The distinction between a trust and a trust contract is more easily seen after the examination of the distinction between a trust contract and other contracts. The first distinction between a trust and a trust contract is that the trust is the result of the trust contract and the trust contract is the source of the trust. However, a trust is not necessarily created by a trust contract. A will or other written documents other than contracts can also create a trust.<sup>126</sup> Secondly, a trust has three parties, the settlor, the trustee and the beneficiary, while a trust contract has only two parties, the settlor and the trustee. Thirdly, a trust is only governed by the law of trusts, while a trust contract is governed by both the law of trusts and the law of contract.

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<sup>126</sup> . The Chinese *Law of Trusts*, article 8.

## 1.3.3 Trust and Agency

### 1.3.3.1 *Trust and agency under the Common Law*

An agency is a legal institution which arises where a person (called agent) is authorized to act on behalf of another person (called principal). It is “a relationship involving authority or capacity in one person (the agent) to create or affect legal relation between another person (the principal) and third parties”.<sup>127</sup> An agency can either be a disclosed agency, in which the agent acts in the name of the principal, or be an undisclosed agency, in which the agent acts in his/her own name, such as a factorage.

Superficially, it seems that there is no distinction between a trust and an agency, especially an undisclosed agency, because they have the following similarities: both a trust and an agency are institutions concerning one person managing and disposing of property for another person; both the trustee and the agent are in the fiduciary relation to the beneficiary and the principal; and both a trustee and an agent may act on behalf of the beneficiary and the principal, respectively, gratuitously or with remuneration.

However, a trust must still be distinguished from an agency. The most important distinction between a trust and an agency is that a trustee has the title to the trust property, while the title of the property of an agency remains in the principal. In other words, a trustee is the legal owner of the trust property while an agent is not the owner of the property authorized by the principal. Also, the title of the trust property must be vested in the trustee, while the title of the property of the principal does not transfer to the agent.

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<sup>127</sup> . Butterworths *Australia Legal Dictionary* (1997), p 37.

Again, a trustee deals with the trust property in accordance with the terms of the trust instrument, while an agent acts within the scope of authority granted by the principal.

In addition, a trustee can sue or be sued with respect to the trust property by virtue of his/her status as the legal owner of the trust property; while under an agency, it is the principal rather than the agent who can be sue or sued with respect to the property of the principal except for in the circumstances of undisclosed agency.

Moreover, a trust will not be terminated by the death, dissolution or resignation of a trustee, while an agency will be terminated by the death, dissolution of either the principal or the agent or terminated by the resignation of the agent.

Lastly, an express trust may be created without the consent of the trustee in that a trust will not fail for want of a trustee, while an agency created by a contract cannot be effective without the consent of the agent.

To distinguish a trust from an agency is of especial importance in the case of administering and disposing of property for others in a long period and in the case of an agency under which the agent pays or receives money for the principal. Generally, a trust is suitable for managing and disposing of property over a long period, while it is better to exploit an agency to manage or dispose of specific property or to deal with other affairs in a short time. During a long period of administering property, some unforeseeable circumstances which will affect the administration and disposal of the property may happen, such as that the managing method should be changed or that the person acts on behalf of others lose the capacity to act or is dead. In this case, if it is an agency, the agent may not fulfil the agency within the scope of the authority granted by the principal by virtue of the changes. Thus the agency may be either modified by the principal and the

agent or be terminated. On the contrary, if it is a trust, the trustee can at any time change his/her method of managing and disposing of the trust property following the change of the circumstances so long as he/she does not violate the trust purpose and the terms of the trust instrument. Also, if the trustee loses his/her capacity to deal with the trust property or dies, the trust will not fail and a new trustee will be selected or appointed to continue to manage and dispose of the trust property.

With respect to the case in which a person receives money from or for another person, the importance of the distinction between a trust and an agency is the same as that between a trust and a debt. If the person acts as a trustee, then the money is trust property and cannot be distributed to the creditors of the trustee when the trustee goes bankrupt. However, if the person acts as an agent, the money he/she receives may be distributed to his/her creditors after he/she goes bankrupt in that the relationship between an agent and his principal may be that of debtor and creditor in the absence of any contrary express or implied intention of the parties.<sup>128</sup>

### ***1.3.3.2 Trust and agency under the Civil Law***

Under the Civil Law jurisdictions, the concept of agency only refers to a direct agency and not an indirect agency. A direct agency, which is similar to the concept of disclosed agency under the Common Law, means that the agent discloses the name of the principal to the third party and the declaration of the intention made by the agent immediately binds the principal. The indirect agency, which is similar to the concept of undisclosed agency under the Common Law, means that the agent acts in his own name without disclosing the name of the principal and the legal consequences of the agency is

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<sup>128</sup>. *Walker v Corboy* (1990) 19 NSWLR 382.

borne by the agent first and then passes to the principal. In the case of an indirect agency, the contract between the agent and the principal and the contract between the agent and the third party are two different and separate contracts. Thus, the contractual obligations between the agent and the third party cannot be assumed directly by the principal. Rather, the agent must bear the contractual obligations first, and then pass the obligations to the principal according to the agency contract between them.

Article 99 (1) of the Japanese *Civil Code* provides:<sup>129</sup>

A declaration of intention, made by an agent within the scope of his authority and disclosing the fact that he is acting for his principal, shall be effective directly for or against the principal.

In addition to this sub-article, the *Code* provides that in certain circumstances, the declaration of intention made by an agent without disclosing the name of the principal still takes effect immediately against the principal if the third party knows the existence of the agency relationship between the agent and the principal. Article 100 of the Japanese *Civil Code* provides:

A declaration of intention made by an agent without disclosing that he is acting for his principal shall be deemed to have been made on his own behalf; however, the provision of paragraph 1 of the preceding Article shall apply mutatis mutandis, if the other party was aware, or should have been aware, that it was made on behalf of the principal.

According to this article, although the agent does not disclose the name of the principal, the third party is aware of the principal. Thus, it is also regarded as a disclosed agency. The reason why the indirect agency is not recognized as an agency in the Civil Law countries is that it cannot directly binds the principal. However, the indirect agency exists widely in practice and is also provided for by law.

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<sup>129</sup> . See also the *Civil Code* of ROC, article 103.

In Civil Law countries, agency is usually divided, according to the bases of creating an agency, into the mandate agency, which arises from the consent of the principal and the agent, and the statutory agency, which arises from legal provisions, such as the guardian of minors.

Article 643 of the Japanese *Civil Code* provides that “a mandate becomes effective when one of the parties has commissioned the other party to do a juristic act, and the latter has consented thereto”.<sup>130</sup> Article 646 (2) of this *Code* also provides:<sup>131</sup>

All rights which the mandatary has acquired in his own name on behalf of the mandator shall be transferred to the mandator.

It is clear that this provision illustrates the existence of the indirect agency. However, this provision does not mean that the principal assumes immediate contractual rights and obligations of the contract entered into by the agent and a third party. On the contrary, it means that the agent acquires the rights first, and then transfers these rights to the principal according to the mandate contract between the principal and the agent. If the principal wants to claim against the third party directly, he/she shall have those rights transferred to him/her from the agent.

Under the Civil Law, a party to a contract can transfer his/her contractual rights and obligations to another party. Article 466 of the Japanese *Civil Code* provides that “a claim may be assigned, unless its nature does not so admit”.<sup>132</sup> The transfer of the

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<sup>130</sup> . Ibid, article 528.

<sup>131</sup> . Ibid, article 541 (2).

<sup>132</sup> . Ibid, article 294.

contractual rights is not effective as against the debtor unless the assignor or the assignee has given notice of the transfer to the debtor.<sup>133</sup>

In the Civil Law countries, the main form of indirect (undisclosed) agency is called commission contract or commission agency which is similar to factorage under the Common Law. Commission agency may be provided for by the commercial code, such as Chapter VI of Book III of the Japanese *Commercial Code* or be provided by civil code, such as the Chapter 8 of Book II of the *Civil Code* of ROC. Article 551 of the Japanese *Commercial Code* provides:<sup>134</sup>

A commission agent is a person who makes it his business to effect sales or purchase of goods in his own name for other person.

Article 552 (1) of the *Code* provides:<sup>135</sup>

By a sale or purchase effected for another person, the commission agent himself acquires and incurs obligations with regard to the other party to the transaction.

In addition to the provision of this Chapter, the provisions relating to Mandates and Agency shall apply mutatis mutandis to the relation between a commission agent and his principal.

It is clear that a commission agency is an indirect agency. Under a commission agency, the legal consequences of the contract between the agent and a third party cannot be assumed by the principal because the principal is not a party to the contract. However, because a commission agency is related to a direct agency by virtue of that the agent acts for the principal although he/she enters into a contract with a third party in his/her own name, the Civil Law jurisdictions provide that the provisions relating to mandate and

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<sup>133</sup> . Ibid, article 297; the Japanese *Civil Code*, article 467.

<sup>134</sup> . The *Civil Code* of ROC, article 576.

<sup>135</sup> . Ibid, article 577 and 578.

direct agency also apply to the relation between a commission agent and his/her principal *mutatis mutandis*.

In China, the law concerning agency is different. Before the Chinese *Contract Law* came into effect on October 1, 1999, neither a commission agency nor any other indirect (undisclosed) agency was recognised. Article 63 (2) of the Chinese GPCL provides:

An agent shall perform civil juristic acts in the principal's name within the scope of the authority of agency. The principal shall bear civil liability for the agent's act of agency.

The Chinese GPCL provides for three types of agency: the mandate agency, statutory agency and designated agency.<sup>136</sup> A mandate agency arises from the principal's authority. It is created by the mandate contract between the agent and the principal. A statutory agency arises from the legal provisions, such as guardians of minors<sup>137</sup> and the directors or managers of corporations.<sup>138</sup> A designated agency arises from the designation of courts or the designating units which are legally empowered to designate guardians for minors or other adults who have no capacity or have limited capacity.<sup>139</sup>

Similar to other Civil Law countries, although the indirect (undisclosed) agency was not provided by law, it existed widely in practice, especially in the area of foreign transactions, in China. In the light of article 9 of the Chinese *Foreign Trade Law*, an enterprise must get special permission to engage in export and import of goods and technology. The organizations and individuals who have not been granted such permission must conduct their foreign trade transactions through those enterprises who

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<sup>136</sup> . Ibid, article 64.

<sup>137</sup> . Ibid, article 14, article 16 (1), (2); article 17 (1).

<sup>138</sup> . Ibid, article 38.

<sup>139</sup> . Ibid, article 16 (3), (4); 17 (2), (3). Designating units mainly refer to the working units of the parents of a minor, the commission of the residential community both in the city and in the countryside of a ward, or civil administration organ.

have the permission and who act as “foreign trade agents”.<sup>140</sup> The “foreign trade agent” enters into a contract with a foreign party in its own name and its Chinese principal who has not been allowed to engage in foreign trade is not a party to the contract. Such “foreign trade agents” are in fact the commission agents under the Civil Law jurisdictions.

When the Chinese *Contract Law* came into effect in October 1, 1999, both the indirect agency and the commission agency were thereby introduced into China. The Chinese *Contract Law* has changed the provisions for agency of the Chinese GPCL in the following aspects.

First, with respect to the case under which the agent does not disclose the principal and the third party is aware of that the agent is acting for the principal, like article 100 of the Japanese *Civil Code*, the Chinese *Contract Law* treats the agency as a disclosed agency and provides that the contract directly binds the principal and the third party.

Article 402 of the Chinese *Contract Law* provides:

Where the agent, in his own name, enters into a contract with a third party within the scope of the authority granted by the principal, the contract binds directly the principal and the third party if the third party is aware of the agency relationship between the agent and the principal at the time when the contract is concluded, unless there is clear evidence stating that the contract only binds on the agent and the third party.

Secondly, with respect to the case where an agent does not disclose the principal and the third party is not aware of that the agent is acting for the principal, the Chinese *Contract Law* provides that in certain circumstances, the agent shall either disclose the existence of the third party to the principal or disclose the principal to the third party so

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<sup>140</sup> . The Chinese *Foreign Trade Law*, article 13.

as to make either the principal exercise the agent's rights against the third party or the third party claim against the principal. Article 403 (1) and (2) of the *Law* provides:

- (1) Where the agent, in his own name, enters into a contract with the third party who is not aware of the agency relationship between the agent and the principal at the time when the contract is concluded, the agent shall disclose the third party to the principal if the agent, by virtue of the third party's cause, fails to perform his obligations to the principal who may thereupon exercise the agent's rights against the third party, unless the third party would not have entered into the contract with the agent had he known the identity of the principal at the time when the contract was concluded.
- (2) Where the agent, by virtue of the principal's cause, fails to perform his obligations to the third party, the agent shall disclose the principal to the third party who may thereupon choose to claim against either the agent or the principal. However, once chosen, the third party may not change the person against whom he claims.

It is noteworthy that with respect to the indirect agency of mandate, this article differs from the provisions of the civil codes of Japan and Taiwan in that it provides that, in certain circumstances, the agent's indirect (undisclosed) act of agency takes effects directly for or against the principal.

Apart from the indirect agency provided for in the mandate, following other civil law jurisdictions, the Chinese *Contract Law* also adopts one chapter, Chapter 22, to provide for commission agency, which is similar to the undisclosed agency under the Common Law. Article 414 of the Chinese *Contract Law* provides:

A commission agency contract is a contract whereby the commission agent, in his own name, engages in trading activities on behalf of the principal and the principal pays remuneration.

Also, article 421 of this *Law* provides that "a commission agent shall directly have rights and undertake obligations under the contract which he/she enters into with a third

party”. In addition, article 423 provides that “the provisions concerning Mandate Contract of this Law shall apply to matters not provided for by this Chapter”.

Compared with a direct agency, a commission agency is more likely confused with a trust by virtue of the similarities between a commission agency and a trust. First, under a commission agency, the agent is mandated with possession, management and control of the goods, while a trustee is also in possession, management and control of the trust property. Second, the agent acts for the principal in his/her own name. The principal’s name is not disclosed to the third party and the principal is not a party to the contract entered into by the agent and the third party. The trustee also acts in his/her own name. Thirdly, the agent directly bears the legal consequences of the contract which he/she enters into with the third party rather than the principal. He/she can sue or be sued in respect of the contract. The trustee also bears the legal consequence of his/her execution of the trust.

Because of these similarities between a trust and a commission agency, a commission agency contract has been some time mistaken as a trust contract by the most authoritative textbooks in China.<sup>141</sup> However, the distinction between a trust and a commission agency is clear and fundamental.

Although the agent is entrusted with the possession, management and control of the goods, the title of the goods is not transferred to the agent, while under a trust, the title of the trust property is transferred to the trustee and the trustee is the legal owner of the trust property.<sup>142</sup> Also, an agent acts in his/her own name and bears the legal consequences of his/her act of agency, but he/she is still required to act within the scope of the authority of

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<sup>141</sup> . Tong Rou: *The Principles of Civil Law* (1987), p 372; Li Youyi: *Civil Law* (1988), p 430.

<sup>142</sup> . Refer to section 1.1.2.2 “the definition of the trust given by the Chinese Law of Trusts” of this thesis.

the principal and controlled by the principal, while a trustee executes a trust in accordance with the terms of the trust instrument and the beneficiary cannot dictate to the trustee with respect to the execution of the trust. Again, the relationship between a principal and a commission agent is a debt. Where the commission agent goes bankrupt, usually, the goods entrusted to the agent will be listed as property in liquidation and distributed among the creditors of the agent. Whilst under a trust, the trust property cannot be regarded as liquidated assets and distributed among the creditors of the trustee after the trustee goes bankrupt. Moreover, a trustee may accept and execute a trust either with or without remunerations, while a commission agent makes the commission agency as his/her business, so the agent engages in commission agency for remunerations.

### **1.3.4 Trust and Bailment**

#### ***1.3.4.1 Trust and bailment under the Common Law***

In *Hobbs v Petersham Transport Co Pty Ltd*,<sup>143</sup> Windeyer J stated:<sup>144</sup>

A bailment comes into existence upon a delivery of goods of one person, the bailor, into the possession of another person, the bailee, upon a promise, express or implied, that they will be redelivered to the bailor or dealt with in a stipulated way.

In *Coggs v Bernard*,<sup>145</sup> Holt CJ classified bailment into the following six categories:<sup>146</sup> gratuitous safe keeping; gratuitous loan; hire; pawn or pledge; contract for work and labour (carriage of goods or performance of services on goods for reward);

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<sup>143</sup> . (1971) 124 CLR 220.

<sup>144</sup> . Ibid, at 238.

<sup>145</sup> . (1703) 2 Ld Raym 909 Com 133; 92 ER 107.

<sup>146</sup> . Ibid, 109.

gratuitous work and labour (carriage of goods or performance of services on goods without reward).

There are some similarities between a bailment and a trust. Both a bailee and a trustee (in many cases) are transferred the possession of the subject matter of a bailment and a trust. Also, both a bailee and a trustee have the duty to take care of the property bailed and the trust property. Again, usually, both a bailee and a trustee are not liable for the loss, damage or destruction of the subject matter if such loss, damage or destruction is caused without the fault of the bailee and the trustee. However, the distinction between a bailment and a trust is clear. Scott cited the judgement of the court in an Iowa case, *Doyle v Burns*,<sup>147</sup> to explain the most important distinction between a bailment and a trust. In this case, the court said:

It fails to distinguish between a bailment and a trust. We are aware that some very good text-writers have made the same mistake. Story on Bailments, section 2; 2 Kent's Commentaries, 559. A bailment exists whenever the ownership and the possession of specific corporeal chattels are lawfully severed from each other. In a trust of personal property, the legal ownership passes to the trustee, and he has something more than bare possession. In cases of bailment the legal ownership is in the bailor, and the bailee simply has possession, which may or may not be for some specific purpose.

In addition, the subject matter of a trust can be either land or chattels, or be either tangible or intangible things. Whilst, the subject matter of a bailment may be chattels, or in some cases may be materialized chose in action (or a piece of paper), such as a certificate of stock, a money order, a bond, or an insurance policy, but the subject matter of a bailment cannot be land.

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<sup>147</sup> . Scott and Fratcher: *The Law of Trusts* (1987, 4<sup>th</sup> ed), §5.

Thirdly, under a bailment, the interests of the bailor and the bailee are legal interests, while under a trust, the interest of the beneficiary must be an equitable interest, but the interest of the trustee may be either (usually) a legal interest or an equitable interest, such as the trustee under a sub-trust.

Fourthly, a bailee cannot transfer the property bailed to a third person because he/she has not the ownership of the property, while a trustee can dispose of trust property in accordance of the terms of the trust instrument.

Moreover, bailment is a common law concept, so the rights of a bailee are determined at the common law. Trust is a concept of equity and the rights of a trustee and beneficiary are determined in equity.

#### **1.3.4.2 Trust and bailment under the Civil Law**

The phenomenon of bailment exists also under the Civil Law. The categories of the bailment under the Common Law can also be found in the corresponding contracts under the Civil Law. However, there is no exact counterpart of bailment in the Civil Law countries. The concept of bailment of the Civil Law is much narrower than that of the Common Law. Under the Civil Law, deposit contract is a typical bailment contract.

Section 11 of Chapter 2, which deals with contracts, of Book Three of the Japanese *Civil Code* is the section governing bailment (deposit). Article 657 of the *Code* provides:

Deposit becomes effective when one of the parties receives a certain thing under an agreement to keep it in his custody on behalf of the other party.

In China and Taiwan, bailment is divided into deposit and warehousing. Article 365 of the Chinese *Contract Law* provides:<sup>148</sup>

A deposit contract is a contract whereby the depositary keeps custody of the deposited thing delivered by the depositor and returns the thing.

Whilst, a warehousing contract is a contract whereby the warehouseman stores the warehoused goods delivered by the depositor and the depositor pays the warehousing fee.<sup>149</sup>

The distinction between a deposit contract and a warehousing contract is that the warehouseman makes the storage and custody of the depositor's goods as a business. Thus a warehouseman undertakes the storage and custody work for remuneration, while a depositary may or may not undertake the custody of a depositor's chattel for remuneration.

With respect to whether a depositary under the custody work for remuneration or not, the *Civil Code* of ROC differs from the Chinese *Contract Law*. Article 589 (2) of the *Civil Code* of ROC provides:

The depositary is not entitled to remuneration unless otherwise provided for by contract or unless according to the circumstances the keeping into custody is not to be assumed to be without remuneration.

Whilst article 366 of the Chinese *Contract Law* provides:

(1) The depositor shall pay a deposit fee to the depositary in accordance with the agreement.

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<sup>148</sup> . See also the *Civil Code* of ROC, article 589 (1).

<sup>149</sup> . The Chinese *Contract Law*, article 381; the *Civil Code* of ROC, article 613.

- (2) If the parties have not agreed on the deposit fee or if their agreement is unclear, and the deposit fee cannot even be determined pursuant to Article 61 of this Law, the deposit is gratuitous.<sup>150</sup>

As a type of bailment, either a deposit or a warehousing is similar to a trust under the Civil Law and the similarities between them are the same as those between a bailment and a trust under the Common Law, such as that one person delivers a chattel to another person who is liable for taking care of it. Similarly, the distinctions between a deposit or a warehousing and a trust under the Civil Law are the same as those between a bailment and a trust under the Common Law. The most important distinction between them is that a depositary or a warehouseman has only the right to possess the deposited thing while a trustee has not only the right to possess, but also the right to use, to manage, and to dispose of the trust property. However, because there is no coexistence of equity and common law under the Civil Law, the distinction which a trust is governed by equity and a bailment is governed by common law does not exist in the Civil Law countries. Thus, in the Civil Law jurisdictions, the trust is governed by the law of trusts, while the bailment is governed by the law of contracts.

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<sup>150</sup> . Article 61 of the Chinese *Contract Law* reads: “After a contract comes into effect, the parties may agree to supplement such terms as quality, price or remuneration and place of performance on which there is no agreement or the agreement is unclear; if no supplementary agreement can be reached, the terms shall be determined in accordance with the related terms of the contract or the usage of transaction”.

## 1.4 Classification of Trusts

### 1.4.1 Classification of Trusts under the Common Law

In Common Law countries, trusts are, according to the methods of creating a trust, usually classified into three categories, namely, express trusts, resulting (implied) trusts and constructive trusts.

#### 1.4.1.1 *Express trusts*

An express trust is created by express intention of the settlor or testator. An express trust may be created *inter vivos* by the express intention of the settlor, or may be created by a will which expresses the intention of the testator. An express trust can also be created by the declaration of a settlor under which the settlor himself/herself acts as the trustee of the trust. No matter whether an express trust is created *inter vivos*, by a will or by the declaration of an owner of property, it must satisfy the requirements of three certainties when it is created.<sup>151</sup> In *Knight v Knight*,<sup>152</sup> Lord Langdale said an express trust contains three certainties without any one of which there is no trust. The three certainties are: the certainty of intention to create the trust; the certainty of the subject matter of the trust; and the certainty of objects.

Express trust can be sub-divided into different categories according to different way of division, such as private trust and public trust, simple trust and special trust, and executed trust and executory trust.<sup>153</sup>

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<sup>151</sup> . See the next chapter of the thesis: the Creation of Express Trust.

<sup>152</sup> . (1840) 3 Beav 148 at 173; 49 ER 58 at 68.

<sup>153</sup> . Meagher and Gummow: *Jacobs' Law of Trusts in Australia* (1997, 6<sup>th</sup> ed), para 306.

### 1.4.1.2 Resulting trusts

A resulting trust is created by the implied expression of the settlor or the testator. There are controversially two categories of resulting trusts: the automatic resulting trust (there is argument about the existence of such a trust) and the presumed resulting trust.

An automatic resulting trust arises by operation of law and it is not dependent on the intention of the person whose conduct has created the trust. For example, where a person transfers property to another person to be held in trust by the transferee, but does not completely dispose of the equitable interest thereby the remaining equitable interest automatically results to the transferor.

The concept of automatic resulting trust was first propounded by Justice Megarry in *Re Vandervell's Trusts (No 2)*,<sup>154</sup> where he said:<sup>155</sup>

- (b) The second class of case is where the transfer to B is made on trusts which leave some or all of the beneficial interest undisposed of. Here B automatically holds on a resulting trust for A to the extent that the beneficial interest has not been carried to him or others. The resulting trust here does not depend on any intentions or presumptions, but is the automatic consequence of A's failure to dispose of what is vested in him. Since ex hypothesi the transfer is on trust, the resulting trust does not establish the trust but merely carries back to A the beneficial interest that has not been disposed of. Such resulting trusts may be called 'automatic resulting trusts'.

However, it is argued that there is no such automatic resulting trust. In *Westdeutsche Landesbank Girozentrale v Islington London Borough Council*,<sup>156</sup> Lord Browne-Wilkinson said that Megarry J's view on automatic resulting trust in *In re Vandervell's*

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<sup>154</sup> . [1974] 1 Ch. 269 at 294.

<sup>155</sup> . Ibid, at

<sup>156</sup> . [1996] AC 669.

*Trusts (No 2)* was not convincing, because the automatic resulting trust also gave effect to the common intention of the transferor and transferee.<sup>157</sup>

A presumed resulting trust is a resulting trust based on the presumed intention of the person whose conduct has created the trust. There is a presumed resulting trust if the presumption of resulting trust is not rebutted by the contrary evidence and there is no presumption of advancement or gift.

A presumption of resulting trust in favour of A arises when A gratuitously or voluntarily transfers property to B who has not provided consideration to A in the following two circumstances: first, A is silent as to whether he/she intends B to take as trustee only or as a beneficiary and there is no presumption of advancement in favour of B; second, A pays for property and directs the vendor to transfer it to B who has not provided consideration to A and there is no presumption of advancement in favour of B.

It is noteworthy that in Australia, there is no presumption of a resulting trust in favour of a voluntary transferor of a personal chattel (including money as personal chattels).<sup>158</sup>

### **1.4.1.3 Constructive trusts**

A constructive trust arises by operation of law. It is imposed whenever equity considers it unconscionable for the legal owner of property to deny another person's partial or entire beneficial interest therein.

Unlike an express trust or a presumed resulting trust, a constructive trust is not created by the intention of any party. The intention may be one element in deciding

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<sup>157</sup> . *Ibid*, at 703.

<sup>158</sup> . *Heydon v Perpetual Executors Trustees and Agency Co (WA) Ltd* (1930) 45 CLR 111; *Joaquin v Hall* [1976] VR 788; *Jenkins v Wynen* [1992] 1 Qd R 40.

whether or not a constructive trust should be imposed, but it is not a decisive element in creating a constructive trust.

Constructive trusts can be divided into institutional constructive trusts and remedial constructive trusts. In *Westdeutsche Landesbank Girozentrale v Islington London Borough Council*<sup>159</sup> Lord Browne-Wilkinson distinguished between these two kinds of constructive trust, saying:

Under an institutional constructive trust, the trust arises by operation of law as from the date of the circumstances which give rise to it: the function of the court is merely to declare that such trust has arisen in the past. The consequences that flow from such trust having arisen (including the possible unfair consequences to third parties who in the interim have received the trust property) are also determined by rules of law, not under a discretion. A remedial constructive trust, as I understand it, is different. It is a judicial remedy giving rise to an enforceable equitable obligation: the extent to which it operates retrospectively to the prejudice of third parties lies in the discretion of the court.

Commonly, a constructive trust is imposed in the following circumstances: namely, it is imposed to prevent the statutory writing requirements from being used as an instrument of fraud; imposed to create fully secret and half-secret trusts; and imposed on strangers who receive trust property either with notice of a breach of trust or pursuant to assisting in another person's breach of fiduciary duty. However, the circumstances to which constructive trusts are applied are not closed.

## **1.4.2 Classification of Trusts under the Civil Law**

Because there are no resulting trusts and constructive trusts in the Civil Law jurisdictions, the classification of trusts under the Civil Law is not the same as that of the

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<sup>159</sup> . [1996] AC 669.

Common Law. Generally, the range of trusts law under the Civil Law jurisdictions can be regarded as a kind of classification in that the range of trusts law is determined by the purpose of creating a trust. According to the purposes of creating trusts, the range of trusts under the Civil Law includes private trusts (or civil trusts), business trusts and charitable trusts. Article 3 of the Chinese *Law of Trusts* provides:

This law shall apply to civil, business and charitable trust activities of the settlor/testator, the trustee and the beneficiary (they shall be named totally as trust parties in the following articles) within the People's Republic of China.

Although the law of trusts of Japan, South Korea and Taiwan do not denote that the range of trusts includes civil, business and charitable trusts in a single article, the three trusts are provided for respectively in these laws of trusts.<sup>160</sup>

In addition, trusts can be also divided into express trusts and statutory trusts according to whether a trust is created by the intention of the settlor/testator or by operation of law. Although the statutory trusts which will be discussed in the following context are created by operation of law, they are not the same as constructive trusts under the Common Law.

Usually, trusts under the Civil Law are classified into different categories within the express trusts according to different methods. According to the purpose of creating a trust, express trusts can be divided into private trusts and charitable trusts. Express trusts can also be divided into express trusts *inter vivos* and testamentary trusts according to whether an express trust is created *inter vivos* or is created by a will. Again, according to whether the trustee undertakes the trust as a business or not, express trust can be divided into business trusts and civil trusts.

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<sup>160</sup> . For example, the concept of business trusts is provided for by article 6 of the Japanese *Law of Trusts* and article 4 of the South Korean *Law of Trusts*. Article 60 of the *Law of Trusts* of ROC concerns the supervision of business trusts.

### **1.4.2.1 Express trusts and statutory trusts**

Trusts can be classified into express trusts and statutory trusts (or trust by operation of law) in the Civil Law countries. An express trust is created by the intention of the settlor or testator, while a statutory trust arises by operation of law. Article 1262 of the Quebec *Civil Code* provides:

A trust is established by contract, whether by onerous title or gratuitously, by will, or, in certain cases, by operation of law. Where authorized by law, it may also be established by judgment.

Article 2 of the *Law of Trusts* of ROC provides that “a trust shall be created by contract or will except that it is otherwise provided by law”. Therefore, according to this article, the trusts, which are created by contracts or wills are express trusts, while those which are not created by the intention of the settlor/testator but created by the legal provisions or by the operation of law, are statutory trusts. For example, after a trust is terminated and pending the transfer of the trust property to the person intended to be vested with it, the trust shall be deemed to continue to exist.<sup>161</sup> In this case, the continued trust is a statutory trust. Also, the application of the cy-près doctrine is also regarded as a charitable trust created the operation of law.<sup>162</sup>

### **1.4.2.2 Private trusts and charitable trusts**

Trusts created for public benefits are charitable trusts. A charitable trust must have a charitable purpose which falls into the category of charitable purposes provided for by

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<sup>161</sup> . The Japanese *Law of Trusts*, article 63; the South Korean *Law of Trusts*, article 61; the Chinese *Law of Trusts*, article 55; the *Law of Trusts* of ROC, article 66.

<sup>162</sup> . The Japanese *Law of Trusts*, article 73; the South Korean *Law of Trusts*, article 72; the Chinese *Law of Trusts*, article 72; the *Law of Trusts* of ROC, article 70.

trusts law of the Civil Law jurisdictions.<sup>163</sup> It is noteworthy that although the meaning of charity is similar among the Civil Law countries, it is not exactly the same. For example, a trust for the advancement of religion is a charitable trust in Japan, South Korea and Taiwan,<sup>164</sup> but it is not recognized as a charitable trust in China.<sup>165</sup>

Those express trusts other than charitable trusts are private express trusts, because they are created for the benefit of individuals.

The significance of dividing express trusts into private trusts and charitable trusts is that the capacity of a trustee, the creation, the supervision, and the principle of a charitable trust is different from those of a private trust. First, the trustee and the creation of a charitable trust shall be approved by relative administrative department.<sup>166</sup> A charitable trust shall be subject to the supervision of the administrative department.<sup>167</sup> In addition, although a charitable trust is a kind of express trust, the important principles of charitable trusts, such as the cy-près principle, are not applicable to other express trusts. Where the original charitable purpose of a charitable trust cannot be realized, the court may apply the cy-près doctrine to another charitable purpose which is as near as possible to the original charitable purpose so as to prevent the charitable trust from being failed. Moreover, in addition to the law of trusts, charitable trusts are also governed by other related laws or regulations. For example, before the enactment of the Chinese *Law of*

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<sup>163</sup> . The Japanese *Law of Trusts*, article 66; the South Korean *Law of Trusts*, article 65; the Chinese *Law of Trusts*, article 60; the *Law of Trusts* of ROC, article 69.

<sup>164</sup> . The Japanese *Law of Trusts*, article 66; the South Korean *Law of Trusts*, article 65; the *Law of Trusts* of ROC, article 69.

<sup>165</sup> . The Chinese *Law of Trusts*, article 60.

<sup>166</sup> . The Japanese *Law of Trusts*, article 68; the South Korean *Law of Trusts*, article 66; the Chinese *Law of Trusts*, article 62; the *Law of Trusts* of ROC, article 70.

<sup>167</sup> . The Japanese *Law of Trusts*, article 67; the South Korean *Law of Trusts*, article 69; the Chinese *Law of Trusts*, article 64; the *Law of Trusts* of ROC, article 60 and 72.

*Trusts*, China enacted the *Law of Charitable Donation* in 1999. The relative provisions of this *Law of Charitable Donation* shall *mutates mutandis* apply to the charitable trusts.<sup>168</sup>

### **1.4.2.3 Trusts created *inter vivos* and testamentary trusts**

#### **1.4.2.3.1 Trusts *inter vivos***

In the Civil Law countries, a trust which is created *inter vivos* is also called a trust by contract, because it is mainly created by the contract between the settlor and the trustee. Article 1262 of the *Quebec Civil Code*, article 2 of the South Korean *Law of Trusts*, article 2 of the *Law of Trusts* of ROC and article 8 (2) of the Chinese *Law of Trusts* provide that a trust *inter vivos* shall be created by contract. Trusts *inter vivos* can also be subdivided into the following two sub-categories: the trusts for the sole benefit of the settlor and the trusts for the benefit of a third person; the trusts of transferring property and the trusts of non-transferring property such as declaration trusts which exist in Taiwan.

#### ***Trusts for the sole benefit of the settlor and trusts for the benefit of third party***

A trust for the sole benefit of the settlor refers to a trust under which the settlor is the sole beneficiary. A trust for the benefit of a third party refers to a trust under which the settlor is not a beneficiary or is only one of the beneficiaries. Where a settlor is the sole beneficiary of a trust, he/she or his/her heirs may at any time revoke the trust.<sup>169</sup> Where the settlor is not a beneficiary or one of the beneficiaries of a trust, the trust cannot be

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<sup>168</sup> . The Chinese *Law of Trusts*, article 59.

<sup>169</sup> . The Japanese *Law of Trusts*, article 57; the South Korean *Law of Trusts*, article 56; the Chinese *Law of Trusts*, article 50; the *Law of Trusts* of ROC, article 63 (1).

terminated by the settlor and other beneficiaries in Japan and South Korea except where it is otherwise provided by the trust act.<sup>170</sup> However, in China<sup>171</sup>, it may be revoked by the settlor with the consent of the beneficiary or of the beneficiaries. In Taiwan,<sup>172</sup> it may be terminated by the settlor and other beneficiaries acting as a whole.

### ***Trusts of transferring property and declarations of trust***

The creation of most of the trusts needs the transfer of the title to the property from the settlor to the trustee. These trusts are trusts of transferring property. However, a settlor can also declare himself/herself as the trustee and holds his/her property on trust for the benefit of a beneficiary or beneficiaries. Such a trust, under which the settlor holds his/her property as a trustee and there is no transfer of the title to the property, is a declaration of trust. A declaration of trust is not recognized by the trusts law of Japan, South Korea, and China. The reason is that an express trust *inter vivos* is created by a contract. A settlor cannot enter into a contract with himself/her self. However, in Taiwan, a declaration of trust is recognized in one specific situation. Article 71 (1) of the *Law of Trusts* of ROC provides that “for the advancement of public benefit, a legal person may declare as a trustee and invite other persons to join as settlors”.

#### **1.4.2.3.2 Business trusts and civil trusts**

A business trust is a trust under which the trustee makes it as its business, while trusts other than business trusts are civil trusts. Article 6 of the Japanese *Law of Trusts* provides

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<sup>170</sup> . The Japanese *Law of Trusts*, article 59; the South Korean *Law of Trusts*, article 58.

<sup>171</sup> . The Chinese *Law of Trusts*, article 51 (1) (c).

<sup>172</sup> . The *Law of Trusts* of ROC, article 64 (1).

that “the acceptance of a trust shall be a commercial transaction when effected as a business”.<sup>173</sup>

Compared with a civil trust, a business trust is different in the following aspects. First, a business trust is not only governed by the trusts law, but also governed by the special business trusts law. For example, in Japan, the Japanese *Law of Business Trusts*, which regulates the business trusts, was enacted on the same day, April 21, 1922, when the Japanese *Law of Trusts* was enacted. In China, three months before the enactment of the Chinese *Law of Trusts*, the People’s Bank of China had also enacted the *Regulations on Management of Trust and Investment Companies* on January 19, 2001.

Secondly, a trustee who engages in business trust shall meet the special requirements of the law. Article 1 of the Japanese *Law of Business Trusts* provides: “Business trusts shall not be conducted unless a license is obtained from the Competent Minister”. The law also provides that “business trusts shall not be conducted except by a limited company”<sup>174</sup> and “a trust company shall use the word ‘trust’ in its corporate name”.<sup>175</sup> In Taiwan, article 2 of the *Law of Business Trusts* of ROC also provides that “the trades of business trusts within the meaning of this Law signifies the institutions which take the trust as their business on the approval of relative administrative office (Ministry of Finance) in accordance of the Law”. In China, apart from that a trust and investment company “is set up according to the Chinese *Company Law* and the *Regulations on Management of Trust and Investment Companies* and that mainly engages in trust business”,<sup>176</sup> “the organization and management of other trustees which conduct business

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<sup>173</sup> . See also the South Korean *Law of Trusts*, article 4.

<sup>174</sup> . The Japanese *Law of Business Trust*, article 2.

<sup>175</sup> . *Ibid*, article 3.

<sup>176</sup> . The *Regulations on Management of Trust and Investment Companies of China*, article 2.

trusts in the form of trust institutions shall be governed by other regulations which will be enacted by the State Council”.<sup>177</sup>

Moreover, a business trust is not a gratuitous trust because the trustee takes a trust as its business, while a civil trust may be or may not be gratuitous.

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<sup>177</sup> . The Chinese *Law of Trusts*, article 4.

## Chapter 2

### Creation of Express Trusts

Theoretically, a charitable trust, also called a public trust, is classified as an express trust. However, as explained in the preceding chapter, a charitable trust has its particular principles which are not applicable to other express trusts. Therefore, charitable trusts will be discussed in the last chapter of this Part and this Chapter will only examine private express trusts.

Private express trusts are divided into express trusts *inter vivos* and testamentary trusts. Express trusts *inter vivos* can be subdivided into trusts created by transferring property, and trusts created by declarations. Because the Chinese *Law of Trusts* does not recognize declarations of trust, the creation of express trusts *inter vivos* in this Chapter refers only to trusts created by transferring property, except where the declarations of trust are discussed in relation to the Common Law jurisdictions.

There are certain requirements for the creation of an express trust, namely the capacity to create a trust, the three certainties, the requirement of formalities, the transfer of the subject matter, and the requirements of legality. However, the requirements of creating an express trust *inter vivos* are not exactly the same as those of creating a testamentary trust.

## 2.1 Capacity to Create an Express Trust

### 2.1.1 The Capacity of the Settlor and the Testator

Under both the Common Law and the Civil Law jurisdictions, to create a valid and enforceable express trust, the settlor and the testator shall be of full legal capacity to hold and dispose of property, or, in other word the settlor and the testator must be *sui juris*. Where a beneficiary of a trust disposes of his/her equitable interests therein to create a sub-trust, he/she shall also be of full legal capacity. Therefore, a minor or an insane person or any other person who is under a legal incapacity cannot create an enforceable trust. Usually, the Common Law and the Civil Law countries provide that a person who attains the age of 18 and is sane has full legal capacity. However, some countries provide different ages of majority. In Canada, article 1 of the *Age of Majority Act* provides that: “From April 15, 1970, (a) a person reaches the age of majority on becoming age 19 instead of age 21, and (b) a person who on that date has reached age 19 but not 21 is deemed to have reached majority on that date”. In Japan and Taiwan, the age of majority is 20.<sup>1</sup>

In China, the age of majority is 18 years, but, according to article 11 (2) of the Chinese GPCL, “a person who has reached the age of 16 years but not the age of 18 years and whose main source of income is his/her own labour shall be regarded as a person with full legal capacity”. Thus, such person is also *sui juris*. According to article 19 of the Chinese *Law of Trusts* which provides that “a settlor or a testator must be *sui juris*”, a person who has reached 18 and a person who has reached 16 under article 11 (1) and article 11 (2) of the Chinese GPCL respectively are *sui juris* and can create a trust.

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<sup>1</sup> . The Japanese *Civil Code*, article 3; the *Civil Code* of ROC, article 12.

## 2.1.2 The Capacity of the Trustee

Under the Common Law, because an express trust will not fail for want of a trustee, with respect to the creation of a trust, it is not a requirement as to whether the intended trustee is of full legal capacity or not. If the intended trustee selected by the settlor or the testator lacks legal capacity, a new trustee will be appointed to continue the trust.<sup>2</sup>

However, under the Civil Law, whether a trustee is required to have full legal capacity in the creation of a valid express trust depends on whether it is an express trust *inter vivos* or a testamentary trust. In the case of a testamentary trust, it is the same as a testamentary trust under the Common Law, and it will not fail for want of a trustee. Article 13 (2) of the Chinese *Law of Trusts* provides:<sup>3</sup>

Where a trustee appointed by the will refuses to act or is incapable of acting therein, the beneficiary, or if the beneficiary is of no legal capacity or of only limited legal capacity, the guardian of the beneficiary will appoint the new trustee or new trustees. Where it is otherwise provided by the will, such provisions of the will shall prevail.

In respect of an express trust *inter vivos*, it is required that a trustee shall be a *sui juris* because an express trust *inter vivos* is created by contract in the Civil Law jurisdictions. Article 1262 of the Quebec *Civil Code* provides clearly that: an express trust *inter vivos* “is established by contract, whether by onerous title or gratuitously”. Article 2 of the South Korean *Law of Trusts* provides that: “a trust may be created by the contract entered into by a settlor or a trustee, or be created by the will of a testator”.<sup>4</sup> According to contract law, as a contracting party, the trustee must have full legal capacity to enter into

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<sup>2</sup> . *Trusts Act* 1973 (Qld), s12 (1).

<sup>3</sup> . See also the Japanese *Law of Trusts*, article 49; the South Korean *Law of Trusts*, article 17; the *Law of Trusts* of ROC, article 46.

<sup>4</sup> . See also the Chinese *Law of Trusts*, article 8 (2); the *Law of Trusts* of ROC, article 2.

a trust contract.<sup>5</sup> Thus, unlike the Common Law, having the legal capacity is a requirement for the trustee to create a valid express trust *inter vivos* under the Civil Law.

## 2.2 The Three Certainties

The three certainties which were declared by Lord Langdale MR in *Knight v Knight*<sup>6</sup> are the basic requirements to create an express trust under the Common Law. They are the certainty of intention to create a trust, the certainty of subject matter (trust property), and the certainty of objects (the beneficiary or beneficiaries). If any one of the three certainties is missing, then there is no express trust.

However, the three certainties for the creation of an express trust under the Common Law are not required by all the Civil Law jurisdictions.

### 2.2.1 Certainty of Intention

#### 2.2.1.1 Certainty of intention under the Common Law

“Equity looks to the intent rather than to the form”. To determine whether a trust is created depends upon the intention of the creator rather than the words used by the creator. In *Lambe v Eames*,<sup>7</sup> a testator gave his estate to his widow “to be at her disposal in any way she may think best for the benefit of herself and family”.<sup>8</sup> The Court of Appeal in Chancery held that the widow took the estate absolutely because those words disclosed no intention to impose a trust.

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<sup>5</sup> . The Chinese GPCL, article 55; the Chinese *Contract Law*, article 9.

<sup>6</sup> . (1840) 3 Beav 148; 49 ER 58 at 173 and at 68 respectively.

<sup>7</sup> . (1871) LR 6 Ch App 597.

<sup>8</sup> . *Ibid*, at 597.

There was a time when there were precatory trusts under which precatory words, which literally merely express request or hope, were construed in context to be imperative words. However, the precatory trusts are not of practical importance today. In *Mussoorie Bank Ltd v Raynor*,<sup>9</sup> the testator had given the whole of his real and personal property to his widow “feeling confident that she will act justly to our children in dividing the same when no longer required by her”.<sup>10</sup> The Privy Council held that the words “no longer required by her” have shown the testator’s intention that his widow was not to take the property as a trustee. Likewise, in *Re Williams*,<sup>11</sup> a testator bequeathed the residue of his estate to his widow in the fullest confidence that she would carry out his wishes in the following particulars. The Court of Appeal held that the words were not imperative and that the widow did not take the property as trustee. As Lindley LJ stated:<sup>12</sup>

Having given the case my best attention, I have arrived at the conclusion that the testator has not used language sufficiently clear to impose upon his widow an obligation to leave either policy to his daughter. I believe, further, that he refrained from language imperative in its terms, such as upon trust or upon condition, and that he has used the language which he did because he really intended to trust his widow’s discretion with respect to his daughter, and not to provide for his daughter himself by putting a legal fetter on his widow’s power of disposition of her own policy or of the property which he left her.

In Australia, it has been established that even a purported express declaration of trust will have no effect if the express declaration is not genuine. Thus, to create a trust, the words merely purporting to create a trust are insufficient if those words are not the

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<sup>9</sup> . (1882)7 App Cas 321.

<sup>10</sup> . Ibid, at 325.

<sup>11</sup> . [1897] 2 Ch 12; [1895-99] All ER Rep 1764

<sup>12</sup> . Ibid, at 22; at 1769.

genuine expression of the settlor's intention. In *Commissioner of Stamp Duties (Qld) v Jolliffe*,<sup>13</sup> the respondent, Jolliffe thought that he could only get interest for one bank account. He purported to set up a trust account for the benefit of his wife for the sole purpose of getting interests payable on more than one account. There was an apparent declaration of trust for this purpose. After his wife died, the appellant, the Commissioner of Stamp Duties of Queensland, relying on the declaration of trust, imposed stamp duty on the assets of the estate of Jolliffe's deceased wife. Jolliffe who was the administrator of his wife's deceased estate, namely in his capacity as his deceased wife's personal representative, argued that no duty was payable as there was no trust in that he had never intended to create a trust in favour of his wife. The High Court held that no trust had been created, because there was no real intention to create a trust. There Knox CJ and Gavan Duffy J stated:<sup>14</sup>

We know of no authority, and none was cited, which would justify us in deciding that by using any form of words a trust can be created contrary to the real intention of the person alleged to have created it.

However, Issacs J dissented because the real intention of Jolliffe, which is for the sole purpose of getting interest payable on more than one account and not for the benefit of his wife, was found merely by oral evidence. His Honour declared:<sup>15</sup>

In my opinion, there are three reasons for rejecting the oral evidence of intention. The first is that, as I have explained, once a clear declaration of trust is made, that is an effectual vesting of the property in equity in the beneficiary... [T]here is no such sweeping rule that, whatever words are used, it is always sufficient, in order to negative a trust, that an actual though undisclosed intention not to create a trust should be proved. The Second reason for not admitting the evidence, though

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<sup>13</sup> . (1920) 28 CLR 178.

<sup>14</sup> . Ibid, at 181.

<sup>15</sup> . Ibid, at 190-191.

by no means so radical as the first and third, is that parol evidence is not available to contradict a written document... The third reason against admitting the evidence is based on public policy.

Although the judgement of Issacs J is not law in Australia, his reasoning appeared more persuasive. As a principle of evidence, the effect of oral evidence is not as strong as written evidence. If the declaration of intention was not made under the outward influence, such as fraud or duress, the settlor of the intention should be bound by the intention. Again, since the real intention is undisclosed, it may not be certain and it is possible for the settlor to disclose other “real” intentions.

### **2.2.1.2 Certainty of intention under the Civil Law**

Under the Civil Law, the certainty of intention is required to create an express trust. Because an express trust is created by a contract or by a will under the Civil Law,<sup>16</sup> the creation of the express trust is not only governed by law of trusts, but also governed by law of contract, by law of succession, and by general provisions of civil law.

The act of entering into a contract or making a will is regarded as a civil juristic act under the Civil Law. It is well settled that a valid civil juristic act must meet three requirements: the actors must have legal capacity; the declaration of intention (the outward expression of intention) shall be genuine; and the juristic act shall not be contrary to laws and public policy.<sup>17</sup> Thus, the three requirements, which decides whether a juristic civil act is valid or not, are also the requirements of creating a trust since a trust is created by a civil juristic act. It is clear that one of the three requirements, namely the

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<sup>16</sup> . The South Korean *Law of Trusts*, article 2; the Japanese *Law of Trusts*, article 1 and 2; the Chinese *Law of Trusts*, article 8; the *Law of Trusts* of ROC, article 2.

<sup>17</sup> .The Chinese GPCL, article 55; see also Section One and Section Two of Chapter Four of the Japanese *Civil Code* and Chapter Four of the *Civil Code* of ROC.

genuineness of the declaration of intention is the same as the certainty of intention under the Common Law.

The certainty of the declaration of intention is the general principle of the effectiveness of a juristic act although it is not clearly provided for by the Chinese GPCL which only provides the genuineness of the declaration of intention. However, the general principle has been provided for by the Chinese *Contract Law*. According to the Chinese *Contract Law*, the process of creating a contract comprises offer and acceptance. A contract arises when the promisee has agreed and accepted the offer of the promisor. An offer is the declaration of intention of a person. Article 14 of the Chinese *Contract Law* provides:

Offer is a declaration of intention to create a contract with another person, and the declaration of intention shall meet the following requirements:

- (1) its content is specific and certain; and
- (2) it indicates that the offeror will be bound by it upon acceptance by the offeree.

The contents of an offer usually include the essential elements of a contract, such as the parties to, and the subject matter of, the contract; the quality and quantity of the subject matter; the price and remuneration; the time, the venue, and the manner of performance; the liability for breach of the contract; and the means of dispute resolution.<sup>18</sup> Accordingly, if there is no certainty of intention, there is no creation of contract.

Moreover, the Chinese *Law of Trusts*, following the Chinese *Contract Law*, clearly provides for the certainty of intention. The Chinese *Law of Trusts* provides that “the

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<sup>18</sup> . The Chinese *Contract Law*, article 12.

creation of a trust must be in writing”<sup>19</sup> and the certainty of intention shall be stated in the written instruments. Article 9 (1) of the Chinese *Law of Trusts* provides:

(1) In regard to the creation of a trust, the written instruments must clearly state the following items:

- (a) the purpose or purposes of the trust;
- (b) the names and addresses of the settlor or testator and the trustee;
- (c) the beneficiary or the range of the beneficiaries;
- (d) the range, type and the condition of the trust property; and
- (e) the methods of the beneficiary to obtain the trust interest

Apart from the essential elements of a trust, article 9 (2) further provides that “except for the provisions of the preceding paragraph, the written instruments may state the period of the trust, the method of managing trust property, the remuneration of the trustee, the way of selecting a new trustee or new trustees, the cause of the termination of the trust, and other items”.

Therefore, compared with the certainty of intention under the Common Law, the intention of the creator of a trust under the Civil Law is not only certain, but also specific and genuine.

However, as to how to determine the genuineness of the declaration of intention, there are two academic principles or standards. One is the subjective principle, which attaches greater importance to the intention. Namely, if the declaration of intention differs from the true intention, the declaration of intention is not genuine. The other is the objective principle, which attaches greater importance to the declaration. This principle regards the declaration of intention is genuine unless the person who expresses the intention can prove that such declaration has been unjustly influenced by others. The civil

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<sup>19</sup> . The Chinese *Law of Trusts*, article 8 (1).

laws of China, Japan and Taiwan adopt the objective principle. According to the Chinese GPCL, the declaration of intention of the declarant, which is made in accordance with the law, is genuine, unless “it is made against the declarant’s true intention as a result of fraud, duress or exploitation of his unfavourable position by the other party”,<sup>20</sup> or unless “it is made by virtue of that the declarant seriously misunderstands the contents of the act”.<sup>21</sup> However, such misunderstanding shall not be due to the declarant’s own fault. For example, article 88 (1) of the *Civil Code* of ROC provides:

A declaration of intention may be avoided by the declarant if he was acting under a mistake as to the contents of the declaration of intention, or had he known the real state of affairs, he would not have made the declaration; provided that the mistake or the ignorance of the real state of affairs was not due to the declarant’s own fault.

Where there is an inconsistency between the declaration of intention and the true intention by reason of the declarant himself/herself, the declaration of intention is not void. Article 86 of the *Civil Code* of ROC provides:<sup>22</sup>

A declaration of intention is not void by reason of the fact that the declarant did not intend to be bound by it, unless such fact was known to the other party.

Thus, if the facts of *Commissioner of Stamp Duties (Qld) v Jolliffe*<sup>23</sup> had occurred in these Civil Law jurisdictions, the judgement of Issacs J would have been the law.

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<sup>20</sup> . The Chinese GPCL, article 58 (3).

<sup>21</sup> . Ibid, article 59 (1).

<sup>22</sup> . See also the Japanese *Civil Code*, article 93.

<sup>23</sup> . (1920) 28 CLR 178.

## **2.2.2 Certainty of Subject Matter**

### **2.2.2.1 Certainty of subject matter under the Common Law**

There is no trust if there is no certainty of subject matter. In *Palmer v Simonds*,<sup>24</sup> it was held that the expression “the bulk of my said residuary estate” only meant “the greater part”<sup>25</sup>, thus, the trust failed for uncertainty of subject matter. In *Sprange v Barnard*,<sup>26</sup> a testatrix gave property to her widower for his sole use provided the remainder is distributed to certain persons. It was held that the phrase “remainder” was not certain.

In *Hunter v Moss*,<sup>27</sup> the defendant, Moss, had declared himself a trustee for the plaintiff, Hunter, of 5% of the issued share capital of 1,000 shares of a company. Thus the defendant owned 950 shares and 50 of the shares were purportedly held in trust for the plaintiff. However, the defendant later changed his mind and argued there was uncertainty of the 50 shares relying on that they could not be identified by their serial numbers. The Court of Appeal rejected his argument and held that there was certainty of subject matter by treating the shares as a single blended fund and as one class of shares of the company.

### **2.2.2.2 Certainty of subject matter under the Civil Law**

Under the Civil Law, the subject matter is the most important essential element. Because the trust act is one of the civil juristic acts, although the certainty of the subject matter is not stipulated by the *Law of Trusts* of Japan, South Korea and Taiwan, the

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<sup>24</sup> . (1854)2 Drew 221; 61 ER 704.

<sup>25</sup> . Ibid, at 227; at 706.

<sup>26</sup> . (1789) 2 Bro CC 585; 29 ER 320

<sup>27</sup> . [1994] 1 WLR 452.

certainty of subject matter is stipulated by the *Civil Codes* of these Civil Law jurisdictions.

In China, except that the Chinese GPCL and the Chinese *Contract Law* provide for the certainty of subject matter,<sup>28</sup> the Chinese *Law of Trusts* clearly stipulates the certainty of subject matter of a trust. Article 9 (1) (d) of the Chinese *Law of Trusts* provides that “to create a trust shall clearly state the range, type and the status of the trust property”. Article 11 (2) of this *Law* also provides that “the trust is void if the trust property is not certain”.

## 2.2.3 Certainty of Objects

### 2.2.3.1. Certainty of objects under the Common Law

There is no private express trust if there is no certainty of objects, in whose favour, the trust will be enforced. The rule of certainty of objects was laid down in *Morice v Bishop of Durham*.<sup>29</sup> In this case, the testatrix bequeathed her residual personal estate to the Bishop of Durham, her executor, to dispose of the estate to such objects of benevolence and liberality as the Bishop of Durham in his own discretion should most approve of. Sir William Grant MR stated:<sup>30</sup>

There can be no trust, over the exercise of which this Court will not assume a control: for an uncontrollable power of disposition would be ownership, and not trust. If there be a clear trust, but for uncertain objects, the property, that is the subject of the trust, is

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<sup>28</sup> . Under the Civil Law, the subject matter is the essential element of a juristic act as well as one of contents of the declaration of intention. Thus, the certainty of the subject matter is provided by the provisions on declaration of intention, because the contents of the declaration of intention shall be specific and definite. See the Chinese *Contract Law*, article 12 and 14.

<sup>29</sup> . (1804) 9 Ves Jun 399; 32 ER 656.

<sup>30</sup> . Ibid, at 404-405; at 658.

undisposed of, and the benefit of such trust must result to those, to whom the law gives the ownership in default of disposition by the former owner. But this doctrine does not hold good with regard to trusts for charity. Every other trust must have a definite object. There must be somebody, in whose favour the Court can decree performance.

Thus, it was held that the objects were too indefinite to be executed by the court and the terms “benevolence” and “liberality” could not signify a charitable purpose, so the purported trust failed for uncertainty of objects.

Under the Common Law, there are two competing tests, namely the list certainty test and the criterion certainty test, for determining certainty of objects.

### **2.2.3.1.1 The list test for certainty of objects**

The list test rule is a strict test, which requires that every member of a class of beneficiaries must be identifiable before there is the requisite certainty and that the trustee must compile a complete list of beneficiaries. The list test rule applies to fixed trusts. However, in certain circumstances, the list test may be modified to apply to a non-fixed trust.

In *West v Weston*,<sup>31</sup> a clause in a will created a trust to “divide the balance then remaining equally (per capita) amongst such of the issue living at my death of my four grandparents...as attain the age of twenty-one (21) years”. On previous authorities, the test would have been the list certainty test, because it had been held that one could not make an equal division among a class of people unless you knew every member of the class. In that case, Young J said it would be a great pity if the trust failed as the testator

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<sup>31</sup> . (1998) 44 NSWLR 657.

had no statutory next of kin and the money would have gone to the Crown as *bona vacentia* if the trust failed. Therefore, Young J modified the list certainty test by saying:<sup>32</sup>

Although the authorities would show that I should follow the English rule, it seems to me that I would be justified in slightly modifying its operation for Australian conditions of the present day. The rule will be satisfied if, within a reasonable time after the gift comes into effect, the court can be satisfied on the balance of probabilities that the substantial majority of the beneficiaries have been ascertained and that no reasonable inquiries could be made which would improve the situation.

Young J in fact did two things which were unorthodox: namely he did not apply the list certainty test to a fixed trust and he applied the test of certainty not at the time that the gift took effect (at the time of the testator's death) but within a reasonable time after his death.

### **2.2.3.1.2 The criterion certainty test of objects**

The criterion certainty test is less strict than the list certainty test. The criterion certainty test is satisfied if the trustee can say with certainty that any postulant of the class is or is not a member of the class and it is not necessary for the trustee to compile a complete list. It is also called "in/out" or "yes/no" test. The criterion certainty test rule applies to mere and trust powers.

#### ***Mere or bare powers***

In *re Gulbenkian's Settlements*<sup>33</sup>, Lord Upjohn described a mere or bare power or a power collateral by saying:<sup>34</sup>

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<sup>32</sup> . Ibid, at 664.

<sup>33</sup> . [1970] AC 508.

<sup>34</sup> . Ibid, at 521.

It is agreed between the parties that the direction to the trustees in cl 2 (i) to pay all or any party of the income of the trust fund at their absolute discretion to one or more of the persons therein mentioned to the exclusion of the others or to apply it for their maintenance, support or benefit is a mere or bare power or a power collateral, as it is sometimes called. It is not a trust power: the trustees have no duty to exercise it in the sense that the court has any power to compel the trustees to exercise it or to exercise itself if the trustees refuse or neglect to do so.

In that case, the trustees were given a mere power to appoint among a class of persons comprising three groups. It was impossible for the trustees to compile a complete list of all the three groups of persons of the class. The House of Lords held that in the case of a mere or a bare power, the criterion certainty test would not be satisfied where the trustee was only to be able to identify one person in the class. Lord Upjohn there stated:<sup>35</sup>

It is curious that there is no long line of decided cases as to what is the proper test to apply when considering the validity of a mere power when the class of possible appointees is or may be incapable of ascertainment, but there is a body of recent authority to the effect that the rule is that provided there is a valid gift over or trust in default of appointment (which was fundamental to the decision of Clauson J in *Re Park* [1932] 1 Ch 580), a mere or bare power of appointment among a class is valid if you can with certainty say whether any given individual is or is not a member of the class: you do not have to be able to ascertain every member of the class.

In that case, Lord Upjohn also held that the time to apply the test of certainty of objects was the time that the relevant instrument took effect, namely the time when the deed was executed, or when the testator died, saying:<sup>36</sup>

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<sup>35</sup> . Ibid.

<sup>36</sup> . *In re Gulbenkian's Settlements* [1970] AC 508 at 524.

I should mention here that it is clear that the question of certainty must be determined as of the date of the document declaring the donor's intention (in the case of a will, his death).

### ***Trust powers***

A trust power is one that a trustee is obligated to exercise. A trust power must be given to a trustee. Property is vested in the trustee and trust power is then conferred upon the trustee to distribute that property. In *re Gulbenkian's Settlements*,<sup>37</sup> Lord Upjohn distinguished a mere power from a trust power by saying:<sup>38</sup>

Again the basic difference between a mere power and a trust power is that in the first case trustees owe no duty to exercise it and the relevant fund or income falls to be dealt with in accordance with the trusts in default of its exercise, whereas in the second case the trustees must exercise the power and in default the court will.

In *McPhail v Doulton (or Re Baden's Deed Trusts)*,<sup>39</sup> the House of Lords held that the criterion certainty test of objects not only applies to mere powers but also to trust powers. This decision overruled the earlier decision made in *Inland Revenue Commissioners v Broadway Cottages Trust*,<sup>40</sup> which required the trustees (or the court) should have the capacity to compile a complete list of beneficiaries.<sup>41</sup> In that case, Lord Wilberforce said:<sup>42</sup>

So I think that we are free to review the *Broadway Cottages* case. The conclusion which I would reach, implicit in the previous discussion, is that the wide distinction between the validity test for powers and that for trust powers is unfortunate and wrong, that the rule recently fastened upon the

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<sup>37</sup> . [1970] AC 508.

<sup>38</sup> . Ibid, at 524

<sup>39</sup> . [1971] AC 424.

<sup>40</sup> . [1955] 1 Ch 20.

<sup>41</sup> . Ibid, at 35-36.

<sup>42</sup> . *McPhail v Doulton* [1971] AC 424 at 456.

courts by *IR Commissioners v Broadway Cottages Trust* ought to be discarded, and that the test for the validity of trust powers ought to be similar to that accepted by this house in *Re Gulbenkian's Settlements* for powers, namely, that the trust is valid if it can be said with certainty that any given individual is or is not a member of the class.

And then, Lord Wilberforce continued to say: “assimilation of the validity test does not involve the complete assimilation of trust powers with powers”.<sup>43</sup> The court would not compel a trustee to exercise a mere power, but would execute a trust power if the trustees do not do so either “by appointing new trustees, or by authorising or directing representative persons of the classes of beneficiaries to prepare a scheme of distribution, or even, should the proper basis for distribution appear by itself directing the trustees so to distribute”.<sup>44</sup>

### **Hybrid power**

A hybrid power is a power to appoint property to anyone in the world except a particular person, particular persons or a class or classes of persons. It is also called an intermediate power which means a power between a general power and a special power. In *Re Manisty's Settlement*,<sup>45</sup> Templeman J upheld that the criterion certainty test applied to a hybrid or immediate power created *inter vivos*. He said that logically the hybrid power was a special power. If the criterion certainty test applied to a special power, it would apply to a hybrid power. In Australia, the criterion certainty test was also applied to a hybrid power.<sup>46</sup>

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<sup>43</sup> . Ibid, at 457.

<sup>44</sup> . Ibid.

<sup>45</sup> . [1974] Ch 72.

<sup>46</sup> . *Horan v James* [1982] 2 NSWLR 376.

### **2.2.3.2 Certainty of Objects under the Civil Law**

It is a requirement of the Civil Law that the contents of a declaration of intention in a civil juristic act shall be certain. Thus, as one of the contents of the declaration of intention, the objects shall be certain and the certainty of objects is also the requirement of creating a trust. However, the certainty of objects differs between China and some other Civil Law Jurisdictions.

#### **2.2.3.2.1 The position in China**

In China, the *Law of Trusts* clearly stipulates that to create a trust it is necessary to have certainty of objects. Article 9 (1) (c) of the Chinese *Law of Trusts* provides: “The written instruments which create a trust shall clearly state the beneficiary, beneficiaries or the class of the beneficiaries”. Also, article 11 (5) of the *Law* provides that “a trust shall be void without the certainty of the beneficiary or the class of beneficiaries”.

Where the trust instrument has clearly listed the beneficiary or beneficiaries, there is no difficulty in enforcing the trust because the trustee does not need to ascertain the certainty of beneficiaries. Nevertheless, the Chinese *Law of Trusts* does not deal with how to determine the question of the certainty of objects where the trust instrument only outlines a class of beneficiaries. It is suggested that to satisfy the requirement of the certainty of the objects, the class of the beneficiaries should be ascertained first whether the trust is fixed or not.

Where the trust is a fixed trust, the class of beneficiaries is fixed. To satisfy the requirement of certainty of objects for a fixed trust, it is suggested that it should be correct to adopt the list test under the Common Law to ascertain every beneficiary of the class by compiling a list of the beneficiaries.

Where the trust is not a fixed trust, namely a discretionary trust, the criterion certainty test should be adopted to satisfy the certainty of objects, namely the trustee can say with certainty whether any given individual is or is not a member of the class. For example, if a person alleges he/she is one of the beneficiaries, the trustee shall say with certainty whether this person is or is not a beneficiary.

### **2.2.3.2.2 The position in Japan, South Korea and Taiwan**

Because, as a general rule, it is required by the civil law that the contents of the declaration of intention of a juristic act shall be certain, the certainty of objects of a trust act shall also be certain. Thus, a private express trust cannot be created for the benefit of a person who is not sufficiently ascertained as a beneficiary of the trust. However the trusts laws in Japan, South Korea and Taiwan all provide that a private express trust can be created without the certainty of the beneficiaries provided that a trust administrator is appointed. Article 8 (1) of the Japanese *Law of Trusts* provides:<sup>47</sup>

In cases where there exist beneficiaries who are indefinite or not yet in existence, the Court may, either upon demand of persons interested or of its own motion, appoint a trust administrator, provided however, that this shall not apply if a trust administrator has been designated in the act of trust.

In February 1993, the Ministry of Justice of Taiwan finished the Draft of the Law of Trusts and there was a legislative explanation corresponding to each article of the Draft. With respect to the “uncertainty of the beneficiaries” provided by article 54 of the Draft,<sup>48</sup> the explanation of this article gave an example and illustrated that there existed uncertainty of beneficiaries in charitable trusts. It is true that a charitable trust can be

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<sup>47</sup> . See also the South Korean *Law of Trusts*, article 18 (1) and the *Law of Trusts* of ROC, article 52 (1).

<sup>48</sup> . It has become article 52 of the *Law of Trusts* of ROC.

created without the certainty of the objects, because it is a purpose trust. But it is also clear that such explanation was not correct because this article did not only refer to charitable trusts.

Some scholars from Taiwan thought that because a beneficiary was not a party to a trust act, it was not necessary to ascertain the beneficiaries at the time of creating a trust so long as the beneficiaries can be identified in the future. Therefore, they, by quoting the explanations of the Japanese scholars, further explained that the “indefiniteness of the beneficiaries” provided by article 52 of the *Law of Trusts* of ROC denoted that although the beneficiaries themselves were indefinite, the class of the beneficiaries was definite.<sup>49</sup> They thought<sup>50</sup> that although the beneficiaries were not certain, however, during the period between the trust was created and the beneficiaries were identified, the beneficial interests have existed. To protect such beneficiary interests, the Law of Trusts had to provide for the appointment of a trust administrator to act in his/her own name on behalf of the indefinite beneficiaries.

It is thought that the opinion of these scholars are not correct. First, if the class of the beneficiaries itself is so definite, such as the grandchildren, that the membership can be ascertained, the beneficiaries are certain. In this case there is no question of “indefiniteness of beneficiaries”. In the case where the class of the beneficiaries is defined by the settlor, if the class is too wide and the settlor or the testator did not appoint the trustee or another person to ascertain the beneficiaries among the class, the trust may fail. For example, property is vested in trustees to hold on trust for the testator’s

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<sup>49</sup> . Lai Yuanhe & Wang Zhichen: *On Modern Law of Trusts* (2000, 2<sup>nd</sup> ed), p 139.

<sup>50</sup> . Lai Yuanhe & Wang Zhichen: *On Modern Law of Trusts* (2000, 2<sup>nd</sup> ed), p 138. In addition, article 52 (2) of the *Law of Trusts* of ROC provides: “A trust administrator shall have power to do any act relative to the trust in and out of Court in his own name, on the behalf of the beneficiaries”. See also article 8 (2) the Japanese *Law of Trusts* and article 18 (2) of the South Korean *Law of Trusts*,

neighbours. The term “neighbour” is uncertain, because the people who will fall into the class of the neighbours of the testator are not ascertainable. Again, the beneficial interests shall be vested in the beneficiary. How could it be said that there is beneficial interest of the beneficiary since there is no ascertainment of the beneficiary. In addition, since the beneficiaries are not identified, it is self-contradictory to say that a trust administrator acts in his/her own name on behalf of the “beneficiaries”.

Certainty of objects is a requirement in the creation of an express private trust. If the beneficiaries are not ascertainable at the time of creation of the trust, they shall be ascertainable at some future time, or the trust will fail.

Thus the provisions of article 8, article 18, and article 52 of the *Law of Trusts* of Japan, South Korea and Taiwan respectively violate the rule of certainty of objects. In addition, the appointment of a trust administrator is redundant because the beneficiaries or their guardians can act in and out of the court to protect themselves so long as the beneficiaries are ascertained. In a discretionary trust, although not every potential beneficiary of a definite class is sure to receive any part of the trust property, each potential beneficiary rather than a trust administrator, shall be entitled to sue the trustee to exercise his/her discretionary power of appointment.

## 2.3 Complete Constitution of Voluntary Trusts

### 2.3.1 Complete Constitution of Voluntary Trusts under the Common Law

A valid and enforceable trust shall be completely constituted. An incomplete constituted trust is not enforceable unless it is for valuable consideration. In *Norman v Federal Commissioner of Taxation*,<sup>51</sup> Windeyer J declared:<sup>52</sup>

But in equity a would-be present assignment of something to be acquired in the future is, when made for value, construed as an agreement to assign the thing when it is acquired. A court of equity will ensure that the would-be assignor performs this agreement, his conscience being bound by the consideration. The purported assignee thus gets an equitable interest in the property immediately the legal ownership of it is acquired by the assignor, assuming it to have been sufficiently described to be then identifiable. The prospective interest of the assignee is in the meantime protected by equity.

In the light of the maxim that: “equity does not assist a volunteer”, the complete constitution of the trust is required to create a valid voluntary trust. Once a trust is completely constituted, it is enforceable by the beneficiaries even if they are volunteers.<sup>53</sup> The maxim that “equity does not assist a volunteer” only means that equity does not assist a volunteer to “perfect an imperfect gift”, but it does not mean that equity does not assist a volunteer under a completely constituted trust.<sup>54</sup> The complete constitution of a voluntary trust requires the complete transfer of trust property to the trustee.

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<sup>51</sup> . (1963) 109 CLR 9.

<sup>52</sup> . Ibid, at 24.

<sup>53</sup> . *Paul v Paul* (1882) 20 Ch D 742 at 744.

<sup>54</sup> . *Milroy v Lord* (1862) 4 De GF & J 264 at 274; 45 ER 1185 at 1189.

### **2.3.1.1 The general rule to complete a voluntary transfer**

The general rule to complete a voluntary transfer, which was laid down by Turner LJ in *Milroy v Lord*,<sup>55</sup> is that the settlor must have done everything which is necessary to be done.

In that case, Medley purported to transfer 50 bank shares to Lord to be held in trust for Milroy. Lord, the intended trustee, had agreed with Medley that he would hold those 50 shares on trust for Milroy. Medley then, by deed, assigned the 50 shares to Lord to be held in trust as had been agreed. This purported method of transfer was not in conformity with the constitution of the bank, which prescribed three steps for the transfer of shares: namely, the execution of a prescribed instrument of transfer by the owner of the shares; the lodgement of such a transfer with the bank accompanied by the relevant share certificate; and the registration of the instrument of transfer by the bank.

It was held by the English Court of Appeal in the Chancery that the trust was not completely constituted, as the method of transferring the shares to Lord was not effectual by virtue of inconsistency with the procedures prescribed by the constitution of the bank. Milroy was only a volunteer and did not have beneficial ownership of the shares. Milroy could not compel Medley to complete the gift. Medley's intention was to make Lord as trustee, not himself. Thus, since there was no transfer of the trust property, the trust failed.

In that case, Turner LJ declared the general rule of completing a voluntary transfer as follows:<sup>56</sup>

I take the law of this Court to be well settled, that, in order to render a voluntary settlement valid and effectual, the settlor must have done everything which, according to

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<sup>55</sup> . (1862) 4 De GF & J 264; 45 ER 1185.

<sup>56</sup> . Ibid, at 274-275; at 1189-1190 respectively.

the nature of the property comprised in the settlement, was necessary to be done in order to transfer the property and render the settlement binding upon him. He may of course do this by actually transferring the property to the persons for whom he intends to provide, and the provision will then be effectual, and it will be equally effectual if he transfers the property to a trustee for the purposes of the settlement, or declare that he himself holds it in trust for those purposes; and if the property be personal, the trust may, as I apprehend, be declared either in writing or by parol; but in order to render the settlement binding, one or other of these modes must, as I understand the law of this Court, be resorted to, for there is no equity in this Court to perfect an imperfect gift.

In Australia, the position is slightly different from that of England. It emphasizes that a donor must do what is necessary for him/her to do. In *Anning v Anning*,<sup>57</sup> a person, being about to die, executed a deed of gift voluntarily conveying to his wife and several infant children in equal shares the whole of his personal properties. Before the death of the grantor, he did nothing except for the execution and delivery of the deed. The High Court of Australia, who explained and applied the general rule laid down in *Milroy v Lord*,<sup>58</sup> held that “the deed was intended to take effect as an absolute conveyance, and, if ineffective for that purpose, could not be made effectual as a declaration of trust. The effect of the deed depended upon whether the donor had, with regard to each particular item of property in question, done all that was necessary on his part to place the donees in the position of the donor, as between him and them”.<sup>59</sup>

In the United States of America, if the purported voluntary transfer by an owner to another person on trust for a third person is incomplete for want of delivery of the subject

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<sup>57</sup> . (1907) 4 CLR 1049.

<sup>58</sup> . (1862) 4 De GF & J 264; 45 ER 1185.

<sup>59</sup> . *Anning v Anning* (1907) 4 CLR 1049 at 1050.

matter or for want of delivery of a deed of conveyance, no trust is created. Section 32 (1) of the *Restatement of Trusts 2d* provides:

Except as stated in Subsection (2), if the owner of property makes a conveyance *inter vivos* of the property to another person to be held by him in trust for a third person and the conveyance is not effective to transfer the property, no trust of the property is created.

Thus, in USA, the effective transfer is required to complete an incomplete voluntary transfer. With regard to the effective transfer, Scott<sup>60</sup> cited the judgement of the court in *Whitehead v Bishop*, which reads:

We think the rule is well settled that a voluntary trust is an equitable gift, and like a legal gift *inter vivos* must be complete. Since delivery is essential to the consummation of a gift, it follows that, whenever the donor undertakes to divest himself of the entire ownership, either by direct transfer to the donee or conveyance to the trustees to hold for the donee's benefit, the transaction will not be complete unless there is actual delivery of the thing given or of the instrument by which the donor signifies his intention of parting with the control of it. If the donor selects a third person to act as trustee, the subject of the trust must be transferred to him in such mode as will be effectual to pass the legal title.

### **2.3.1.2 The application of the general rule to various properties**

#### **2.3.1.2.1 Personal chattels**

At common law, to transfer a title of personal chattel by way of gift, there are two methods: actual or constructive delivery of the personal chattel to the intended donee with the intention of making a gift; or execute and deliver a deed of gift in favour of the donee. "Equity follows the law", thus, a settlor must do what is necessary for him/her to

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<sup>60</sup> . Scott and Fratcher: *The Law of Trusts* (1987, 4<sup>th</sup> ed), §32 (2).

do to either, execute and deliver the deed of a gift, or deliver the personal chattel actually or constructively in order to satisfy the requirement of the general rule.

The position of the law was implicitly approved in *Cochrane v Moore*.<sup>61</sup> In *Anning v Anning*,<sup>62</sup> Griffith CJ assumed this proposition of law was correct by saying:<sup>63</sup>

With respect to the horses and cattle and other chattel property capable of manual delivery comprised in the deed, the gift would be valid according to the law of England, which allows such property to be transferred either by delivery or by instrument under seal.

### 2.3.1.2.2 Land under the Torrens System

In the light of the Torrens System of title registration, the legal title to land can be transferred only by the registration of a prescribed memorandum of transfer.<sup>64</sup> With regard to the registration, a question as to whether a purported transfer of a Torrens title land is effective before the registration and if so, what steps the transferor shall take to complete the transfer, arises.

In *Corin v Patton*,<sup>65</sup> a joint tenant of land registered under the Torrens system in New South Wales, Mrs Patton, shortly before her death, executed three documents to sever the joint tenancy with her husband, Mr Patton, and to transfer of her interest to a trustee to be held on trust for her. She died before the transfer was registered and the certificate of title to the land was held at all times by a mortgagee. The three documents were as follows: (a) a memorandum of transfer in registrable form, in which, without any valuable

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<sup>61</sup> . (1890) 25 QBD 57.

<sup>62</sup> . (1907) 4 CLR 1049.

<sup>63</sup> . *Ibid*, at 1061-1062. See also the similar judgments by Isaacs J (at 1076) and Higgins J (at 1077-1078) in this case.

<sup>64</sup> . *Land Title Act* 1994 (Qld), s 181; *Real Property Act* 1900 (NSW), s 41; *Land Titles Act* 1980 (Tas), s 49; *Real Property Act* 1886 (SA), s 67; *Transfer of Land Act* 1958 (Vic), s 40; and *Transfer of Land Act* 1893 (WA), s 58.

<sup>65</sup> . (1990) 169 CLR 540.

consideration, she transferred her interest in the land to her brother, Mr. Corin, and which transfer was expressed to be subject to a mortgage to a bank which held the certificate of the title; (b) a deed in which Mr Corin declared that he held that interest in the land in trust for Mrs. Patton; and (c) the will of Mrs Patton in which she left her estate to her children in equal shares. After the death of Mrs Patton, Mr Corin lodged a caveat claiming an interest under the transfer, while Mr Patton lodged a caveat to claim an interest in the land as surviving joint tenant.

It was held that the execution of the transfer did not sever the joint tenancy, thus the claim of Mr Corin failed. The key points of this case is that Mrs Patton did not give the mortgagee bank the authority to release the certificate of title to Corin to enable him to register the memorandum of transfer. Here, Mason CJ and McHugh J said:

The question is then whether Mrs. Patton did all that it was necessary for her to do in order to effect a transfer. Two obstacles are suggested to completion of the gift. First, the certificate of title remained throughout with the mortgagee and Mrs. Patton took no steps to arrange for its production for the purposes of registration. Secondly, it is not clear whether or not Mr. Smallwood held the executed transfer on Mrs. Patton's instructions or those of Mr. Corin.

In *Corin v Patton*,<sup>66</sup> Mason CJ and McHugh J, followed *Anning v Anning*,<sup>67</sup> modified the general rule laid down in *Milroy v Lord*,<sup>68</sup> which requires a settlor to do everything which, according the nature of the property, is necessary to be done, by saying:<sup>69</sup>

Accordingly, we conclude it is desirable to state that the principle is that, if an intending donor of property has done everything which it is necessary for him to have done to

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<sup>66</sup> . (1990) 169 CLR 540.

<sup>67</sup> . (1907) 4 CLR 1049.

<sup>68</sup> . (1862) 4 De GF & J 264; 45 ER 1185.

<sup>69</sup> . (1990) 169 CLR 540 at 559.

effect a transfer of legal title, then equity will recognize the gift. So long as the donee has been equipped to achieve the transfer of legal ownership, the gift is complete in equity. “Necessary” used in this sense means necessary to effect a transfer. From the viewpoint of the intending donor, the question is whether what he has done is sufficient to enable the legal transfer to be effected without further action on his part.

Thus, the rule laid down by Turner LJ in *Milroy v Lord* was modified from that “a settlor must have done everything which, according to the nature of the property, is necessary to be done” to that “an intending donor must have done everything which it is necessary for him/her to have done to effect a transfer without further action on his/her part”.

In conclusion, to complete a transfer of Torrens title land, the intended donor must give the intended donee the instrument of transfer and enable the intended donee to use the certificate of title for the purpose of registering the instrument.

### **2.3.1.2.3 Choses in action**

Both legal and equitable choses in action are allowed to be assigned by the statutes in Australia.<sup>70</sup> In the light of section 199 of the *Property Law Act 1974* (Qld), the assignment of a chose in action must meet the following requirements. First, there must be an absolute assignment of the chose in action, not by way of charge only, although it was held in *Tancred v Delagoa Bay & East Africa Railway*<sup>71</sup> that the assignment of a chose in action by way of mortgage is regarded as absolute assignment. Secondly, the absolute assignment must be of the entire chose in action and not be of merely a part of

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<sup>70</sup> . *Property Law Act 1974* (Qld), s 199; *Property Law Act 1969* (WA), s 20; *Property Law Act 1958* (Vic), s 134; *Law of Property Act 1936* (SA), s 15; *Conveyancing Act 1919* (NSW), s 12; and *Conveyancing and Law of Property Act 1884* (Tas), s 86.

<sup>71</sup> . (1889) 23 QBD 239.

the chose in action. Thus, only a part of chose in action cannot be assigned under this section. Section 199 of the *Property Law Act 1974 (Qld)* does not prescribe that a part of chose in action cannot be assigned. It only means that section 199 of the *Act* does not apply to the assignment of a part of chose in action. Thirdly, the absolute assignment must be in writing and signed by the assignor. Fourthly, express written notice of the assignment must be given to the debtor or the person who is liable under the chose in action. The notice can be given either by the assignor or the assignee and the assignment takes effect from the date of the giving of such notice. Fifthly, the assignment takes effect subject to equities having priority over the right of the assignee. This means that the defence of a bona fide purchaser of the legal estate for value without notice is not available to an assignee even for value.

Apart from the statutory assignment of choses in action, there are also authorities on the assignment of choses in action. In *Olsson v Dyson*,<sup>72</sup> a husband had purported to assign to his wife a debt due to him by saying to her orally that she could have the £2,000 which the husband had lent to another person, Tom. It was held by the Australian High Court that the purported assignment was neither valid at law nor in equity because it was merely an oral assignment. This case established that an entire common law chose in action cannot be orally assigned voluntarily either at law or in equity.

However, in *Norman v Federal Commissioner of Taxation*,<sup>73</sup> it was stated that a part of common law chose in action may be assigned orally without the valuable consideration in equity.

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<sup>72</sup> . (1969) 120 CLR 365.

<sup>73</sup> . (1963) 109 CLR 9.

Moreover, with regard to company shares which are one of the most common types of chose in action, the position is different. Section 1070A (1) and (3) of the *Corporation Act* 2001(Cth) provide that subject to a company's constitution, equitable interests in shares may be created, dealt with and enforced in the same way as other personal property. Section 1071B (2) of the *Corporation Act* 2001 (Cth) provides that notwithstanding anything in its constitution, a company must not register a transfer unless a proper instrument of transfer has been delivered to the company.

### **2.3.2 Complete Constitution of Trust under the Civil Law**

Under the Civil Law, the transfer of the subject matter from the settlor to the trustee is also required as a condition for the creation of a private express trust. All of the definitions of the trust given by the trusts laws in Japan, South Korea, China and Taiwan express the meaning that the creator transfers or otherwise disposes of a property right and causes the trustee to administer or dispose of the property for the interests of the beneficiary or beneficiaries, or for specific purpose or purposes.<sup>74</sup> Accordingly, the transfer of the property right is a requirement for the creation of a valid and enforceable trust. Being vested with the property rights of the subject matter is a prerequisite of a trustee's ability to perform his/her duties.

However, because the trusts laws in these jurisdictions do not distinguish a voluntary trust from a trust for valuable consideration, there arises a question as to whether the creation of a trust with valuable consideration needs the transfer of the trust property. If creating such a trust for valuable consideration still needs the transfer of the subject matter, the trust under which a settlor agrees, for valuable consideration, to transfer the

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<sup>74</sup> . The Japanese *Law of Trusts*, article 1; the South Korean *Law of Trusts*, article 1 (2); the Chinese *Law of Trusts*, article 2; the *Law of Trusts* of ROC, article 1.

property at a future date or to transfer the property which he/she will acquire at a future date, cannot be validly created. In addition, under the Common Law, if the settlor who creates a trust for valuable consideration does not transfer the subject matter, a beneficiary or a trustee can sue the settlor for transferring the trust property. But can a beneficiary or a trustee do so under the Civil Law?

Under the Civil Law, because an express trust *inter vivos* is mainly created by a trust contract<sup>75</sup> and a trust is distinct from a contract, the question is related to the time of the formation of a trust contract and the time of the creation of a trust.

### **2.3.2.1 The time of formation of a trust contract and the time of creation of a trust**

Since an express trust *inter vivos* is created by a contract under the Civil Law, is the time of the creation of the trust is the time of the formation of the trust contract? This question depends upon the nature of the contract of creating a trust. It embodies in two categories of contracts.

#### **2.3.2.1.1 The two categories of contracts**

Unlike a contract under the Common Law, a contract under the Civil Law may be formed with or without consideration. Consideration is not a requirement to create some contracts, such as a gift contract,<sup>76</sup> a contract of loan for use,<sup>77</sup> a contract of loan for consumption without interest<sup>78</sup>. This results in a division between contracts as onerous

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<sup>75</sup> . However, article 71 of the *Law of Trusts* of ROC provides that a declaration trust can be created by a legal person for charitable purposes.

<sup>76</sup> . The *Civil Code of Japan*, article 549; the *Civil Code* of ROC, article 406; The *Chinese Contract Law*, article 185.

<sup>77</sup> . The *Civil Code of Japan*, article 593; the *Civil Code* of ROC, article 464.

<sup>78</sup> . The *Civil Code of Japan*, article 587 and 590 (2); the *Civil Code* of ROC, article 474 and 475.

contracts and gratuitous contracts. An onerous contract is a contract under which the parties mutually pay valuable considerations, mutually enjoy and bear contractual rights and obligations, such as a sales contract. A gratuitous contract is a contract under which only one of the parties pays valuable consideration while the other is merely a volunteer, such as a gift contract.

In addition, contracts can be also divided into the contracts formed by agreement and the contracts formed by transfer of subject matter. Where a contract is created when the parties to the contract mutually consent with each other in regard to the essential terms of the contract, the contract is a contract formed by agreement. Where a contract is created not only when the declarations of intention of the parties coincide, but also when the subject matter of the contract is transferred from one party to the other, the contract is a contract formed by transfer of subject matter. This division corresponds to the division of onerous contracts and gratuitous contracts. Generally, an onerous contract is also a contract formed by agreement; likewise, a gratuitous contract is also a contract formed by transfer of subject matter. If a party to a contract formed by agreement (onerous contract) fails to transfer the subject matter, the other party can sue for breach of contract. Where a party to a contract formed by transfer of subject matter (gratuitous contract) agrees to transfer the subject matter to the other party, but he/she fails to transfer the subject matter, the other party cannot sue the default party in that the contract has not been created at all. For example, a gift contract is not enforceable before the donor of the contract transfers the subject matter to the intended donee because the formation of a gift contract requires the transfer of the subject matter,<sup>79</sup> unless the gift is executed in writing,<sup>80</sup> is made for the

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<sup>79</sup> . The Chinese *Contract Law*, article 186; the Japanese *Civil Code*, article 550; the *Civil Code* of ROC, article 408 (1).

<sup>80</sup> . The Japanese *Civil Code*, article 550; the *Civil Code* of ROC, article 408 (2).

discharge of a moral obligation<sup>81</sup> or for the charitable purposes such as the relief of poverty or assistance of victims of disasters, or is made in form of notarization.<sup>82</sup> Thus, the time of the formation of an onerous contract is different from that of a gratuitous contract.

It is noteworthy that under the Chinese civil law, the concept of the formation of a contract (成立 *Chengli*) is different from the effectiveness of a contract (生效 *Shengxiao*). The Chinese *Contract Law* provides for the formation of a contract and the effectiveness of a contract in its Chapter Two and Chapter Three respectively.<sup>83</sup> The formation of a contract means the process of concluding a contract and it is completed when the offer is accepted. The Chinese *Contract Law* provides that: “a contract is formed when the acceptance comes into effect”<sup>84</sup> and “the place where the acceptance comes into effect is the place where the contract is formed”.<sup>85</sup> The effectiveness of a contract means a contract is formed validly and is enforceable at law. Article 44 of the Chinese *Contract Law* provides: “A contract that is formed in accordance with the law comes into effect at the time of its formation”. According to the distinction between the two concepts, the formation of a contract arises when the parties to the contract mutually consent to the essential terms of the contract, while the effectiveness of a contract arises when the contract which has been formed satisfies the requirements prescribed by law. Thus, whether a contract takes effect or whether it is enforceable at law depends on whether the formation of the contract satisfies the requirements prescribed by law. Although a contract is formed, it does not necessarily bind the contracting parties if it is not formed

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<sup>81</sup> . The *Civil Code* of ROC, article 408 (2); the Chinese *Contract Law*, article 188.

<sup>82</sup> . The Chinese *Contract Law*, article 188.

<sup>83</sup> . See also Japanese *Civil Code*, section 1 (1) (Formation of contract) and section 1 (2) (Effectiveness of contract) of Chapter Two (Contract) of Book Three.

<sup>84</sup> . The Chinese *Contract Law*, article 25.

<sup>85</sup> . The Chinese *Contract Law*, article 34.

effectively. For example, where a person who is not *sui juris* enters into a contract of sale of a bicycle with another person, it does not take effect because one of the contracting parties has no legal capacity to enter into the contract though the contract is formed. In addition, some contracts themselves prescribe some conditions for the effectiveness of the contracts in their terms, such as the contracts with a condition precedent or a condition subsequent. Although the contracts are formed, they will not take effect until the conditions are realized. Of course, the conditions must be lawful. In the light of the distinction between the formation of contract and the effectiveness of contract, some scholars said, “formation of contract is essentially a matter of the intention of the parties, whilst the effectiveness of contract is primarily a matter of legal validation of the parties’ agreement”.<sup>86</sup>

The practical significance of the Chinese *Contract Law* drawing a distinction between the formation and effectiveness of contract may possess two aspects. The first significance lies in the Chinese *Civil Procedure Law*. Article 25 of the *Procedure Law* provides that “the parties to a contract may choose, in their written agreement, the court in the place where the contract is formed has jurisdiction over the case”. The second significance of the distinction is that although a contract is formed, “if the contract is void or avoided, the party who was at fault shall compensate the other party for the loss caused thereby”.<sup>87</sup>

It is thought that the distinction drawn by the Chinese *Contract Law* is not necessary, because the effectiveness of contract, according to the *Law*, actually means the valid formation of contract. Logically, the formation of contract should mean the valid

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<sup>86</sup> . Bing Ling: *Contract Law in China* (2002), p 59.

<sup>87</sup> . The Chinese *Contract Law*, article 58.

formation of contract. If a contract is not validly formed, it is not formed. In other words, there is no valid formation, there is no contract. Once a contract is validly formed, the parties to it are under the legal binding effect of the contract. Therefore, the Chinese *Contract Law* should combine the chapter on the formation of contract and the chapter on the effectiveness of contract together, and excise the redundant provisions.

### **2.3.2.1.2 The time of the formation of a trust contract and the complete constitution of a trust**

A trust contract, as a contract creating a trust, is also governed by the law of contracts. Because the time of the formation of a contract formed by agreement is different from that of a contract formed by transfer of subject matter, the time of the formation of a trust contract depends on whether the trust contract is a contract formed by agreement or a contract formed by transfer of subject matter. Thus, the time of the constitution of a trust will depend on the time of formation of the relevant type of trust contracts.

A settlor may create a trust voluntarily or for valuable consideration. Where the settlor creates the trust voluntarily, the trust contract is a gratuitous contract which falls into the category of the contracts formed by the transfer of subject matter. Accordingly, the trust is completely constituted at the time when the trust contract is validly formed, namely when the trust property is transferred to the trustee.

Where the settlor creates the trust for valuable consideration, the trust contract is an onerous contract and is formed when the contracting parties agree with the essential terms of the contract. In this case, the trust also comes into effect at the time when the trust contract is formed. If the settlor does not transfer the trust property after the trust contract has been formed, either the trustee or the beneficiary can sue, according to the

contract law or the law of trusts respectively, the settlor to perform the contract as the other party to the contract, or to transfer the trust property as a party to the trust.

In Taiwan, scholars commonly regard a trust contract as comprising two juristic acts, the contractual act and the trust act.<sup>88</sup> The contractual act is completed when the parties of the contract mutually consent to the declarations of intention made by each other, while the trust act is completed when the trust property is transferred to the trustee. They, in fact, sever the trust contract from the trust and regard the trust contract as general contract, namely the contract formed by agreement. Thus, no matter whether the settlor purports to create a trust with or without valuable consideration, the trustee, as the other party to the contract, can sue the settlor to perform the trust contract to transfer the trust property if the settlor does not do so. This view, although commonly accepted in Taiwan, violates the basic principle of the formation of a gratuitous contract. Some other scholars in Taiwan, although they accept the above common view, think that the trust contract may be construed as a contract formed by the transfer of the trust property according to the definition of the Draft of the Law of Trusts in Taiwan.<sup>89</sup> This view is also not correct because it prevents the settlor from creating a trust with the property he/she can acquire at a future date.

In China, some scholars think that both of the views represented by the scholars in Taiwan are not applicable due to the above reasons.<sup>90</sup> Although they do not proffer any solution to the problems, they propose that where a trust contract is regarded as a contract formed by transfer of subject matter, it is not fair for a trustee who accepts the trust for

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<sup>88</sup> . Lai Yunhe & Wang Zhicheng: *On Modern Trusts Law* (2000, 2<sup>nd</sup>), p 42; Xu Guoxiang: *Studies on Trusts Law* (1988, 2<sup>nd</sup>), pp 58-59.

<sup>89</sup> . Fang Jialing: *The Theory and Practice of Trusts Law* (1994), p 226. The definition of trust in the Draft of the Law of Trusts of ROC was absolutely accepted by the later *Law of Trusts* of ROC.

<sup>90</sup> . Zhou Xiaoming: *A Comparative Study on Trusts Law* (1996), pp 128-129.

remuneration if the trust simply fails by reason of that the settlor does not transfer the trust property to the trustee.<sup>91</sup>

The scholars in China did not notice the distinction between the trust and the trust contract. They equated the formation of a trust contract to the creation of a trust. Where the settlor creates a trust for valuable consideration, both the trust contract and the trust are formed after the parties agree on the essential terms of the contract no matter whether the trustee acts for remuneration or not.

Where the settlor enters into a trust contract to create a trust voluntarily with the trustee who acts for remuneration without transferring the trust property to the trustee, it is suggested that there should be two options. One is that the trust will not be validly created if there is no transfer of the trust property, but the trust contract is validly formed because the trustee's remuneration can be regarded as a kind of consideration of service. Thus, although the trust itself is not validly created, the trust contract is formed. The intended trustee can sue the settlor for breach of the contract and claim compensation for the remuneration. However, the trustee cannot compel the settlor to transfer the intended trust property so as to create the trust, because the intended beneficiary is a volunteer and the trust itself is not completely constituted. The other option is that both the trust contract and the trust have not been formed. The intended trustee can claim the settlor to bear the pre-contractual liability according to article 42 of the Chinese *Contract Law*, which provides:

A party shall liable for compensation if he, in the course of concluding the contract, cause damage to the other party in one of the following situations:

- (1) negotiates in bad faith under the pretext of concluding a contract;

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<sup>91</sup> . Ibid.

- (2) intentionally conceals a material fact relevant to the conclusion of the contract or gives false information; or
- (3) engages in other acts that violates the principle of good faith.

### **2.3.2.1.3 The internally inconsistent provisions in the Chinese Law of Trusts<sup>92</sup>**

Article 2 of the Chinese *Law of Trusts* defines a trust as “the settlor or testator mandates the trustee the property rights and the trustee, according to the will of the settlor or testator, administers or disposes of the trust property for the interests of the beneficiary or for specific purpose in his/her own name”. In a trust *inter vivos*, the transfer of the trust property rights from the settlor to the trustee is the vital element in the creation of a trust. However, article 8 (3) of the *Law* gives a contradictory provision, by stipulating:

Where a trust is created by the trust contract, the trust shall be created when the trust contract is signed by the parties. Where a trust is created by other written instrument, the trust shall be created when the trustee accepts the trust.

On the one hand, the Chinese *Law of Trusts*, in its definition of the trust, requires the transfer of the trust property; on the other hand, it accepts the view of the scholars of Taiwan and provides that a trust contract is nonetheless a contract formed by agreement, which can be formed without the transfer of the property rights. In the light of article 8 of the *Law*, no matter whether the settlor purports to create a trust for valuable consideration or not, the trust is completely constituted so long as the parties consent to the contractual declarations of the intention.

Article 8 (3) of the Chinese *Law of Trusts* rests on the view, prevalent in some Civil Law jurisdictions, that a contract in writing is legally binding on the contracting parties,

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<sup>92</sup> . See also section 7.1.1.1 “Deficiencies in the provisions regulating the methods of creating a trust” of this thesis.

even if the contract is a gratuitous one. For example, in Japan and Taiwan, a donor cannot revoke a gift contract which is made in writing.<sup>93</sup> If a gift made in writing is not executed, the donee may claim the delivery of the subject matter or its value.<sup>94</sup> Since the creation of all the trust needs to be in writing in China, the trust is created at the time when the trust contract is formed by the mutual concurrence of the declarations of intention of the contracting parties. If the settlor does not transfer the trust property after the trust has been created, either the trustee, as a party to the trust contract, or the beneficiary, as a party to the trust, can sue the settlor to transfer the property.

If it is said that which a written trust contract can be created without the transfer of the trust property is rational in Japan and Taiwan, it is cannot be said it is lawful in China, because, in China, the formation of a gift contract depends on the transfer of the subject matter, not on the written formality of the contract. Article 128 of the *Opinions on Certain Questions Concerning the Application of the General Principle of Civil Law of the P.R.C*, which was issued by the Supreme People's Court of China in 1988, clearly provides a gift only comes into effect on the transfer of the subject matter. In addition, article 186 of the Chinese *Contract Law* provides lucidly:

- (1) The donor may revoke the gift before the property rights have been transferred to the donee.
- (2) The preceding paragraph does not apply to gift contracts that are formed for the public benefit, such as the relief of poverty and assistance of victims of natural disaster, or for the discharge of moral obligations, and does not apply to gift contracts that have been notarised.

Because article 8 (3) of the Chinese *Law of Trusts* is contradictory of the principle of gift prescribed in the Chinese GPCL and the Chinese *Contract Law* as well as contradictory to the definition of the trust given by the *Law of Trusts*, it should be better

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<sup>93</sup> . The Japanese *Civil Code*, article 550; the *Civil Code* of ROC, article 408.

<sup>94</sup> . The *Civil Code* of ROC, article 409.

to modify article 8 (3) as: “Where the settlor creates a voluntary trust, it is completely constituted when the trust property right is transferred to the trustee; where the settlor creates the trust for valuable consideration, the trust is completely constituted when the trust contract is formed”, or, alternatively, to cancel this article 8 (3) of the Chinese *Law of Trusts* directly.

### **2.3.2.2 The transfer of the trust property under the Civil Law**

Under the Civil Law, there are two methods of transferring property rights which differ between different properties. One is the transfer by registration of the property rights, such as the transfer of land, or the assignment of a chose in action; the other is the transfer by delivery, such as the transfer of personal properties. With regard to the transfer by registration, the trusts laws in Japan, South Korea and Taiwan are different from that of China.

#### **2.3.2.2.1 The position in Japan, South Korea and Taiwan**

In Japan, South Korea and Taiwan, a trust cannot be created against a third person without the registration of the property right which is required to be registered or recorded. Article 3 (1) of the Japanese *Law of Trusts* provides:<sup>95</sup>

With regard to property rights which are to be registered or recorded, a trust cannot be created against third persons, unless it is registered or recorded.

If a trust is created without the registration of the property rights which are required to be registered or recorded, the validity of the trust is incomplete because it cannot be asserted against third persons. For example, in case where A transfers a piece of land to B who holds it on trust for C, but the transfer of the piece of land is not registered, a third

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<sup>95</sup> . See also the *Law of Trusts* of ROC, article 4 (1); the South Korean *Law of Trusts*, article 3 (1).

person D, who is the creditor of A, can claim the piece of land because the title of the land has not transferred from A to B according to the provisions of the *Civil Code* of Japan. Where the transfer from A to B has been registered, the piece of land is trust property and the title of the land is vested in B. In this case, D, the creditor of A cannot claim it. The formality of registration is indeed a method of public announcement which publishes facts to everybody in order to guard third persons from the danger of frauds or unexpected losses.

In respect of valuable securities, shares and debentures, registration is not required, but the transfer of the choses in action is required to be noted down clearly as trust properties. Article 3 (2) of the Japanese *Law of Trusts* provides:<sup>96</sup>

With regard to valuable securities, a trust cannot be created against third persons, unless in accordance with the provision of Imperial Ordinance it is indicated on the instruments that they are trust properties, and with regard to shares and debentures, unless entries are also made in the book of shareholders or of debentures to the effect that they are trust properties.

Actually, article 3 of the Japanese *Law of Trusts* corresponds to article 177 of the Japanese *Civil Code*, which provides that:

The acquisition or loss of, or any alteration in a real right over an immovable cannot be set up against a third person until it has been registered in accordance with the provisions of law concerning registration of property.

However, article 4 and article 3 of the *Law of Trusts* of ROC and South Korea are inconsistent with article 758 and article 188 of the *Civil Code* of ROC and South Korea respectively with regard to the transfer of immovables. The *Civil Codes* of ROC and

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<sup>96</sup> . See also the *Law of Trusts* of ROC, article 4 (2); the South Korean *Law of Trusts*, article 3 (2).

South Korea require that the registration is a precondition to make the transfer effective. For example, article 758 of the *Civil Code* of ROC provides:<sup>97</sup>

Rights over immovables, which are acquired, created, lost and altered according to juristic acts, are not effective until registration has been done.

According to the *Civil Code* of ROC, there is no effective creation or transfer of a real right over immovables between the parties to the juristic act unless such creation or transfer has been registered; while according to the *Law of Trusts* of ROC, although such creation or transfer cannot be set up against a third person if it has not been registered, the creation or transfer of the real right over immovables is effective between the parties. Although such inconsistency, which an ineffective transfer under the *Civil Code* is valid under the *Law of Trusts*, can be explained by adopting the principle that the specific law is prevailing over the general law, it might be simply that a kind of negligence occurred in the course of transplanting the Japanese *Law of Trusts* into Taiwan and South Korea.

With respect to other properties, the transfer of the property rights shall be transferred in accordance with the method provided in *Civil Codes* of Japan, South Korea and Taiwan. The method of transfer such properties is the delivery of the property.<sup>98</sup>

#### **2.3.2.2.2 The position in China**

In China, there are also two methods of transferring property rights, namely the transfer by registration and the transfer by delivery. Usually, the transfer by registration applies to the transfer of immovables, such as the transfer of the right to use land,<sup>99</sup>

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<sup>97</sup> . See also the South Korean *Civil Code*, article 188.

<sup>98</sup> . The Japanese *Civil Code*, article 178; the *Civil Code* of ROC, article 761 (1).

<sup>99</sup> . The Chinese *Provisional Regulations on the Assignment and Transfer of the Rights to Use State-Owned Land in Urban Areas*, article 31.

transfer of a house,<sup>100</sup> or the assignment of a chose in action.<sup>101</sup> However, with regard to the transfer by registration, the Chinese *Law of Trusts* regards registration as a condition of creating a valid trust. This attitude is different from those of the Japan, South Korea and Taiwan. Article 10 of the Chinese *Law of Trusts* provides:

- (1) With respect to the trust property rights which are required to be registered by relevant laws or administrative rules, a trust cannot be created validly unless the property rights have been registered.
- (2) Where the registration has not been made in accordance with the preceding paragraph, it shall be re-registered; where the re-registration has not been carried out, the trust shall not take effect.

Thus, in the light of the Chinese *Law of Trusts*, there cannot be a valid trust if there is no registration of such property rights. This requirement is too rigid and harsh. For example, where a testator intends to create a testamentary trust, although he/she had transferred the trust property and delivered the documents for registration to the trustee before he/she died, the testamentary trust has not, according to the Chinese *Law of Trusts*, taken effect so long as the transfer is not registered.

In China, with respect to a voluntary transfer, there is not a general rule as clear as that of the Common Law, namely the rule that a settlor must have done everything that is necessary for him/her to be done. However, the Supreme People's Court has established a similar principle in relation to a gift. Article 128 of the *Opinions on Certain Questions Concerning the Application of the General Principle of Civil Law of the P.R.C* provides:

The constitution of a gift between natural persons takes effect by the delivery of the gift property.

Where the subject matter of the gift is a house, the gift is effective if the transfer of the property rights of the house have been registered. Where the registration has not been carried out, the gift

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<sup>100</sup> . The Chinese *Urban Housing Administrative Law*, article 60, 61.

<sup>101</sup> . The Chinese *Patent Law*, article 10 (3); the Chinese *Security Law*, article 41, 43.

may be determined as effective if the donor has delivered the certificate title of the house to the donee in accordance with the gift contract, and the donee, according to the gift contract, has possessed and used the house, however, the donee shall be ordered to carry out the registration.

According to this article, although a gift of house has not been registered, it still may be effective so long as it satisfies two requirements: the donor has delivered the certificate title of the house to the donee and the donee has possessed and used the house. According to the Chinese *Urban Housing Administrative Law* and its relevant rules, the registration of the transfer of a house can be achieved by rendering the certificate title of the house and the contract of transfer. If the donor has delivered the certificate title of the house to the donee in accordance with the gift contract, the donee himself/herself can carry out the registration. It can be said that the donor has done what he/she can have done to enable the donee to register the transfer if he has delivered the certificate title of the house to the donee. Considering that a house is one of the most important valuable assets of a natural person in China, the *Opinions* of the Supreme People's Court requires that the effectiveness of an unregistered gift of a house depends on meeting the two conditions above.

It is suggested that the principle established by article 128 of the *Opinions* of Supreme People's Court should be borrowed by the Chinese *Law of Trusts* to supplement its article 10.

In respect of personal properties, the transfer shall be effective by the delivery of the properties. According to the Chinese GPCL, the ownership of property shall be transferred by delivery. Article 72 (2) of the *Law* provides:<sup>102</sup>

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<sup>102</sup>. See also the Chinese Contract Law, article 113.

Unless the law stipulates otherwise or the parties concerned have agreed on other agreements, the transfer of the ownership of property obtained by contract or other lawful acts shall take effect by the delivery of the property.

The delivery shall also comprise actual delivery as well as constructive delivery.

## 2.4 Writing Requirements for the Creation of Certain Trusts

### 2.4.1 Writing Requirements under the Common Law

The writing requirements were first introduced by the English *Statute of Frauds* 1677.

Section 7 of this *Statute* provides:

All declarations or creations of trusts or confidences of any lands, tenements, or hereditaments, shall be manifested and proved by some writing signed by the party who is by law enabled to declare such trust, or by his last will in writing, or else they shall be utterly void and of none effect.

The object of the *Statute* was to prevent fraudulent claims. Lord Upjohn said in *Vandervell v Inland Revenue Commissioners*<sup>103</sup> that the object of the *Statute* was “to prevent hidden oral transactions in equitable interests in fraud of those truly entitled, and making it difficult, if not impossible, for the trustee to ascertain who are in truth his beneficiaries”.<sup>104</sup>

The *Statute of Frauds* 1677 was originally applicable to express trusts *inter vivos* as well as to trusts by will, but, in England, it was superseded by the English *Law of Property Act* 1925 and the English *Wills Act* 1837 which was amended by *Administration*

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<sup>103</sup> . [1967] 2 AC 291.

<sup>104</sup> . *Ibid*, at 311.

*of Justice Act 1982* respectively. The writing requirements are applicable to land or any interest in land and to equitable interests. Section 53 (1) (b) of the *Law of Property Act 1925* (UK) provides:

A declaration of trust respecting any land or any interest therein must be manifested and proved by some writing signed by some person who is able to declare such trust or by his will.

With respect to equitable interests, section 53 (1) (c) of the *Act* provides:

A disposition of an equitable interest or trust subsisting at the time of the disposition must be in writing signed by the person disposing of the same, or by his agent thereunto lawfully authorised in writing or by will.

A will which purports to create a testamentary trust involving land or any interests therein and equitable interests, except for being required to satisfy the above writing requirements, must satisfy the requirements provided for by section 9 of the *Wills Act 1837* which reads:

No will shall be valid unless:

- (a) it is in writing, and signed by the testator, or by some other person in his presence and by his direction; and
- (b) it appears that the testator intended by his signature to give effect to the will; and
- (c) the signature is made or acknowledged by the testator in the presence of two or more witness present at the same time; and
- (d) each witness either—
  - (i) attests and signs the will; or
  - (ii) acknowledges his signature, in the presence of the testator (but not necessarily in the presence of any other witness),

but no form of attestation shall be necessary.

The English *Statute of Frauds 1677* and the English *Wills Act 1837* were accepted by most of the states of the United States. According to Scott, the statutes in the great

majority of the American states require the writing formalities in creating a trust of land and many of the statutes use the language of the English *Statute of Frauds* 1677.<sup>105</sup> Citing many authorities, Scott said that “in states in which there is no statute requiring a writing with reference to the creation of a trust, there is some authority to the effect that where the owner of land transfers it to another in trust for himself, a writing is necessary, but where he transfers it in trust for a third person a writing is not required”.<sup>106</sup> In addition, in a few states of America, it is held that an enforceable trust can be created orally no matter whether the owner of the interest in land creates the trust by declaration or by way of transfer, however, the court held such trusts must be proved by clear and convincing evidence or by evidence that is unequivocal.<sup>107</sup>

In Australia, the English *Statute of Frauds* 1677 was also accepted and the relevant sections of the *Statute* were re-enacted.<sup>108</sup> An example of such a re-enactment is the *Property Law Act* 1974 (Qld). Sections 10, 11, 12 and 59 of the *Act* specify the writing requirements for the creation and disposition of certain properties, but they are not concerned with the formalities of making a will. The formalities of a will are provided for by section 9 of the *Succession Act* 1981 (Qld).

Section 10 of the *Property Law Act* 1974 (Qld) deals solely with legal interests in land. Section 10 (1) of the *Act* provides that “no assurance of land shall be valid to pass an interest at law unless made by deed or in writing signed by the person making such assurance”. Section 10 (2) of the *Act* provides for some exceptions that are not presently relevant.

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<sup>105</sup> . Scott and Fratcher: *The Law of Trusts* (1987, 4<sup>th</sup> ed), §40.1.

<sup>106</sup> . *Ibid.*

<sup>107</sup> . *Ibid.*

<sup>108</sup> . *Conveyancing and Law of Property Act* 1884 (Tas), s 36, 60; *Conveyance Act* 1919 (NSW), s 23c, 54A; *Law of Property Act* 1936 (SA), s 26 (1), 29; *Property Law Act* 1958 (Vic), s 53, 126; *Property Act* 1969 (WA), s 34; *Property Law Act* 1974 (Qld), s 11, 59.

Section 11 of the *Property Law Act 1974 (Qld)* is the most critical provision. It provides:

- (1) Subject to this Act with respect to the creation of interests in land by parol –
  - (a) no interest in land can be created or disposed of except by writing signed by the person creating or conveying the same, or by the person's agent lawfully authorised in writing, or by will, or by operation of law; and
  - (b) a declaration of trust respecting any land must be manifested and proved by some writing signed by some person who is able to declare such trust or by the person's will; and
  - (c) a disposition of an equitable interest or trust subsisting at the time of the disposition, must be manifested and proved by some writing signed by the person disposing of the same, or by the person's agent lawfully authorised in writing, or by will.
- (2) This section does not effect the creation or operation of resulting, implied, or constructive trusts.

The three paragraphs of section 11(1) of the *Act* overlap with each other semantically, but they cannot be applied concurrently because they specify different writing requirements. A particular transaction may fall within more than one paragraph of section 11 (1), but only one paragraph can be applied. It is noteworthy that the two types of requirements laid down in section 11(1) in Queensland are not as stringent as that required in other states. In Queensland, paragraph (a) of section 11 (1) requires the creation of interests in land must be made in writing, while paragraphs (b) and (c) of the subsection require that a declaration of trust respecting any land and a disposition of an existing equitable interest are merely manifested or evidenced by some writing. In other states, for example in New South Wales, except that a declaration of trust respecting any

land is required to be merely manifested or evidenced by some writing,<sup>109</sup> both the creation or disposition of interest in land and disposition of an existing equitable interest are required to be in writing.<sup>110</sup> Any failure to comply with these writing requirements would have made the relevant transactions void.<sup>111</sup>

Section 12 of *Property Law Act 1974* (Qld) provides:

- (1) All interests in land created by parol and not put in writing and signed by the person so creating the same, or by the person's agent lawfully authorised in writing, shall have, despite any consideration having been given for the same, the force and effect of interests at will only.
- (2) Nothing in this Act shall affect the creation by parol of a lease taking effect in possession for a term not exceeding 3 years, with or without a right for the lessee to extend the term for any period which with term would not exceed 3 year.

Section 59 of the *Act* deals with the contracts for the sale or dispositions of land by providing:

No action may be brought upon any contract for the sale or other disposition of land or any interest in land unless the contract upon which such action is brought, or some memorandum or note of the contract, is in writing, and signed by the party to be charged, or by some person by the party lawfully authorised.

According section 59, the agent is not required to be authorised in writing, so he/she may sign with an oral authorisation. Also, a failure to comply with this section merely makes the contract unenforceable, not void. It is distinct from the failure to comply with section 11 (1).

Apart from the above sections, section 6 of the *Property Law Act 1974* (Qld) provides that “nothing in sections 10 to 12 or 59 of the *Act* invalidates any disposition by will,

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<sup>109</sup> . *Conveyancing Act 1919* (NSW), s 23C (1) (b).

<sup>110</sup> . *Conveyancing Act 1919* (NSW), s 23C (1) (a) and (c).

<sup>111</sup> . *Grey v Inland Revenue Commissioners* [1960]AC 1 at 13 (per Viscount Simonds).

affects the right to acquired an interest in land because of taking possession or affects the law relating to part performance”.

With respect to a disposition by a will, the certain formalities of the will are required by *Wills Acts* or *Succession Act* in Australia. For example, section 9 of the *Succession Act* 1981 (Qld) provides:<sup>112</sup>

A will shall not be valid unless it is in writing and executed in manner hereinafter mentioned and required (that is to say) it shall be signed at the foot or end thereof by the testator or by some other person in the testator’s presence and by the testator’s direction and such signature shall be made or acknowledged by the testator in the presence of 2 or more witnesses present at the same time and such witnesses shall attest and shall subscribe the will in the presence of the testator but no form of attestation shall be necessary provided that –

- (a) the court may admit to probate a testamentary instrument executed in substantial compliance with the formalities prescribed by this section if the court is satisfied that the instrument expresses the testamentary intention of the testator; and
- (b) the court may admit extrinsic evidence including evidence of statements made at any time by the testator as to the manner of execution of a testamentary instrument.

## 2.4.2 Writing Requirements under the Civil Law

In the Civil Law jurisdictions, the writing requirements of a trust *inter vivos* are quite different from those of a testamentary trust. The former must comply with the provisions of both the trusts law and the contract law, while the latter shall be in accordance with the provisions prescribed for wills.

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<sup>112</sup>. See also *Wills, Probate and Administration Act* 1898 (NSW), s 7; *Wills Act* 1936 (SA), s 8; *Wills Act* 1938 (NT), s 8; *Wills Act* 1968 (ACT), s 9; *Wills Act* 1970 (WA), s 8; *Wills Act* 1992 (Tas), ss 10 and 11; *Wills Act* 1997 (Vic), s 7.

### **2.4.2.1 Writing requirements of a trust inter vivos**

As a general rule of the civil law, the change of real rights over immovables shall be registered.<sup>113</sup> However, the results of registration differ as between Japan, Taiwan and South Korea. As discussed above,<sup>114</sup> in Taiwan and South Korea, the registration is the prerequisite of the effect of the transfer or creation because the civil codes of Taiwan and South Korea provide that the creation and transfer of real rights over immovables are not effective until registration is obtained.<sup>115</sup> In Japan, because article 176 of the Japanese *Civil Code* provides that “the creation and transfer of real rights take effect by a mere declaration of intention by the parties”, the registration does not affect the effect of the creation and transfer; nonetheless, according to article 177 of the Code, the creation and transfer “cannot be set up against a third person until it has been registered in accordance with provisions of law concerning registration of property”.

For corresponding to its Civil Code, article 3 (1) of the Japanese *Law of Trusts* provides that “with regard to property rights which are to be registered or recorded, a trust cannot be created against third persons unless the rights are registered or recorded”. Accordingly, the Japanese *Law of Trusts* does not require written formalities for creating a trust involving the transfer real rights over immovables. However, such trust cannot be created against a third person if the real rights over immovables have not been registered or recorded in accordance with the relevant legal provisions.

On the contrary, the trusts laws in South Korea and Taiwan do not accept the general rule of registration of the civil law provided in their civil codes, rather, the civil codes of

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<sup>113</sup> . The Japanese *Civil Code*, article 177; the South Korean *Civil Code*, article 188; the *Civil Code* of ROC, article 758.

<sup>114</sup> . See also section 2.3.2.2 “The transfer of the trust property under the Civil Law” of the Thesis.

<sup>115</sup> . The *Civil Code* of ROC, article 758; the South Korean *Civil Code*, article 188.

Taiwan and South Korea, following the Japanese *Law of Trusts*, also provide that “a trust of which the property rights are required to be registered cannot be created against third persons unless the property rights are registered”.<sup>116</sup>

Registration itself is writing and usually the documents rendered for registration are in writing, thus, article 760 of the *Civil Code* of ROC specifically provides that: “the transfer or creation of rights over immovables must be in writing”. However, it is not sufficient to effect a transfer or creation of rights over immovables if the transfer or creation is only made in writing. The transfer or creation takes effect only when the relevant document is registered.

With respect to the transfer of valuable securities, the trusts law in Japan, South Korea and Taiwan also provide that a trust cannot be created against third persons unless the valuable securities are earmarked as trust properties.<sup>117</sup>

Therefore, in Japan, South Korea and Taiwan, there is no writing requirement for the creation of a trust. However, if the subject matter of a trust is an immovable or are valuable securities, the trust cannot be created against a third person unless the transfer of the immovable has been registered or the valuable securities have been earmarked as trust property.

In China, although article 56 of the Chinese GPCL provides that “a civil juristic act may be in writing, oral or other form”, the Chinese *Law of Trusts* provides that the creation of trust must be in writing. Article 8 (1) and (2) of the *Law* provides:

- (1) The creation of a trust must be in writing.

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<sup>116</sup> . The South Korean *Law of Trusts*, article 3 (1); the *Law of Trusts* of ROC, article 4 (1).

<sup>117</sup> . The Japanese *Law of Trusts*, article 3 (2); the South Korean *Law of Trusts*, article 3 (2); the *Law of Trusts* of ROC, article 4 (2).

- (2) The written formalities include trust contracts, wills and other written instruments prescribed by laws and administrative regulations.

The written requirement applies to all kinds of properties, namely immovables, movables and choses in action. In addition to article 8, article 10 of the Chinese *Law of Trusts* provides that:

- (1) With respect to the trust property rights which are required to be registered by relevant laws or administrative rules, a trust cannot be created validly unless the property rights have been registered.
- (2) Where the registration has not been made in accordance with the preceding paragraph, it shall be re-registered; where the re-registration has not been carried out, the trust shall not take effects.

There is no problem in requiring real rights over immovables or intellectual properties registered, but there are difficulties associated with the registration of valuable securities, shares or debentures. For example, a business trustee who holds large quantity of company shares may sell and purchase shares frequently. It is not realistic to register the shares every time when he/she sells or purchases the shares. Thus, it is suggested that, with respect to the valuable securities, shares and debentures, article 3 (2) of the Japanese *Law of Trusts* should be considered and followed by the Chinese *Law of Trusts*. Namely, with regard to securities, a trust cannot be created validly unless it is indicated on the securities that they are trust properties; with regard to shares and debentures, a trust cannot be created validly unless entries are also made in the book of shareholders or of debentures to the effect that they are trust properties.

### **2.4.2.2 The formalities of a will**

To create a testamentary trust, the will must satisfy the requirements of a will prescribed by law of succession.

In Japan, wills are divided into two categories: the ordinary forms of wills, which comprise holograph will, notarial will and sealed will; and the special forms of wills, which comprise oral will made by a person in imminent danger of death, written will made by a person who is quarantined by virtue of contagious disease, written will made by a person on board a ship, oral will made by a person in immediate danger of death on board a distressed ship, and will made by a Japanese resident in foreign country.<sup>118</sup> With respect to an oral will made by a person in imminent danger of death, it must be made in the presence of at least three witnesses and such oral will shall not be valid unless within twenty days from the day when the will is made one of the witnesses or some person interested applies to the Family Court and obtains a confirmation thereof.<sup>119</sup> Where an oral will is made by a person in immediate danger of death on board a distressed ship, it must be made in the presence of at least two witnesses and shall not be valid unless one of the witnesses or a person interested applies without delay to the Family Court and obtains a confirmation thereof.<sup>120</sup>

In Taiwan, article 1189 of the *Civil Code* of ROC classified wills into the following five forms: holograph will; notarial will; sealed will; dictated will; and oral will.

A dictated will means a written will made on behalf of the testator. Article 1194 of the *Code* provides:

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<sup>118</sup> . The Japanese *Civil Code*, article 967 to article 984.

<sup>119</sup> . Ibid, article 976 (1) and (4).

<sup>120</sup> . Ibid, article 979 (1) and (3).

For making a dictated will, the testator must designate at least three witnesses, make an oral statement of his testamentary wishes, have it written down, read over and explained by one of the witnesses; after the testator has given his approval, the statement bearing the year, month and day, and the name of the draftsman, must be signed by all the witnesses and the testator together.

Where the testator is not able to sign his name, he must affix his finger print in lieu of signature.

An oral will can be made by a testator who cannot make a will in any other form by virtue of the imminent danger of death or other exceptional circumstances. In June 2002, a will made by sound-recording was accepted as a form of oral will in article 1195 of the *Civil Code* of ROC. It is required that an oral will shall be made in the presence of at least two witnesses and it will lose its effect three months after the time when the testator is able to make a will in another form.<sup>121</sup> Within three months after the death of the testator, an oral will must be submitted by one of the witnesses or an interested person for decision by the Family Council as to its genuineness. Where any objection arises concerning with the decision of the Family Council, it will be determined by the Court on application.

In China, there are five forms of wills, the notarial will, the holograph will, the dictated will, the oral will and the sound-recording will. Article 17 of the Chinese *Succession Law* provides:

- (1) A notarial will is one made by a testator through a notary office.
- (2) A holograph will is one made in the testator's own handwriting and signed by him, specifying the date of its making.
- (3) A dictated will shall be witnessed by two or more witnesses, of whom one writes the will, dates it and sign it along with the other witness or witnesses and together with the testator.
- (4) A will made in the form of sound-recording shall be witnessed by two or more witnesses.

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<sup>121</sup> . The *Civil Code* of ROC, article 1196.

- (5) A testator may, in an emergency situation, make a nuncupative will, which shall be witnessed by two or more witnesses. When the situation is over and if the testator is able to make a will in writing or in the form of a sound-recording, the nuncupative will shall be invalidated.

A dictated or a sound-recording will is devised for illiterate people and disabled people, such as a blind person. An oral will can only be created in an emergency circumstance.

Compared with the latter four kinds of wills, a notarial will is of the highest effect. A notarial will cannot be revoked or varied by a holograph will, dictated will, sound-recording will or an oral will.<sup>122</sup> Where the testator has made several wills which are inconsistent with each other, the last made will is effective,<sup>123</sup> but if there is notarial will, the notarial will shall prevail and if there are more than one notarial will, the last made notarial will shall be prevail.<sup>124</sup>

## 2.5 Legality of Trusts

A trust which satisfies the requirements of the capacity, three certainties, complete constitution and writing will not be effective and enforceable if it does not satisfy the requirement of legality. Therefore, the creation of trust must be in conformity with the requirements of legality, otherwise it will be invalid.

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<sup>122</sup> . The Chinese *Succession Law*, article 20 (3).

<sup>123</sup> . *Ibid*, article 20 (2).

<sup>124</sup> . The Supreme People's Court: *Opinions on Certain Questions Concerning the Application of the Succession Law of PRC* (1985), article 42.

## **2.5.1 Legality of Trusts under the Common Law**

Section 60 of the *Restatement of Trusts 2d* provides that “an intended trust or a provision in the terms of a trust is invalid if illegal”. According to the Comment on the section, a trust can be invalidated by virtue of the following two reasons: one is that the purpose of creating the trust is illegal, such as inducing the commission of illegal acts, encouraging of divorce or separation, defrauding creditors or government, restraining marriage or religious freedom; the other is that although the trust is not intended to be created illegally, the trust contravenes public policy, such as violating the rules against perpetuities and accumulations.

Under the Common Law, most illegal trusts are trusts created for illegal purposes. The rules governing the transfer of property in trust for illegal purposes are not uniform throughout the Common Law jurisdictions.

### ***2.5.1.1 The American position***

Where an express trust fails for the illegal purpose, does the trustee hold the trust property for the settlor on a resulting trust or can the trustee keep the trust property as an unjust enrichment? Likewise, can a transfer of property for an illegal purpose cause the transferee to hold the property on a resulting trust for the transferor or can the settlor of an implied resulting trust enforce it if the resulting trust is established for an illegal purpose? If the settlor or transferor can recover the property by resulting trust, recovery may be inconsistent with public policy, while if the settlor or the transferor cannot recover the property, the trustee or the transferee may be enriched unjustly.

In respect of the questions above, Scott thought that it depended on whether the policy against permitting unjust enrichment of the trustee or the transferee is outweighed

by the policy against giving relief to a person who has voluntarily entered into an illegal transaction.<sup>125</sup> He stated that:<sup>126</sup>

There is no doubt that as between the parties it is more just to require the trustee to surrender the property to the settlor than to permit the trustee to keep it. When the trustee is permitted to keep it, it is on the ground that there is a public policy against recovery by the settlor. The only justification for such a policy would seem to be that it might discourage others from creating trusts for such purposes. The rule denying relief to the settlor, however, seems to be so arbitrary in its operation that its value as a preventive measure may well be doubted.

In the United States of America, “in spite of the general rule denying relief to one who has created a trust that fails for illegality” or who has transferred property for illegal purpose, a resulting trust may arise in the following situations. Where property is devised or bequeathed upon trust for an illegal purpose, a resulting trust will always be imposed in favour of the testator’s heir or next of kin or residuary devisee or legatee. A resulting trust may also be imposed where this tends to prevent the accomplishment of the illegal purpose. Again, where the parties are not *in pari delicto*, a resulting trust may be imposed if the trustee is more at fault than the settlor. Moreover, where the settlor’s conduct was not blameworthy, a resulting trust may be imposed. In addition, where the settlor or the transferor can prove the existence of the resulting trust without showing the illegal purpose, the resulting trust will be upheld.<sup>127</sup>

### **2.5.1.2 The English position**

With regard to an illegal transfer, in England, a resulting trust can be imposed if the transferor can prove it without disclosing the illegal purpose. This position was lucidly

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<sup>125</sup> . Scott and Fratcher: *The Law of Trusts* (1989, 4<sup>th</sup> ed), §422 and § 444.

<sup>126</sup> . Ibid, §422.

<sup>127</sup> . Ibid, §422.1 and § 444.

stated in *Tinsley v Milligan*.<sup>128</sup> In this case, two ladies, Miss Tinsley and Miss Milligan jointly bought a house, in which they lived together and ran a lodging business. The title to the house was vested in the sole name of Miss Tinsley, the appellant, but on the understanding that they were joint beneficial owners of the house. The purpose of vesting the title to the house in the name of the appellant was to enable the respondent, Miss Milligan to defraud the Department of Social Security. A number of years after the respondent made the false benefit claims, a quarrel between the parties led to the appellant moving out, leaving the respondent in occupation. Relying on her legal title, the appellant gave the respondent a notice to quit and brought an action against the respondent claiming the sole ownership of the house. The respondent counterclaimed for a declaration that the appellant held her legal title for both of them as equitable tenants in common in equal shares.

The majority of the House of Lords dismissed the appellant's claim and upheld the respondent's counter claim by the presumption of a resulting trust in favour of the respondent. Lord Browne-Wilkinson thought that in this case, the presumption of advancement "does not directly arise for consideration" by virtue of that the parties were only two single women who were not in a position like "a man to his wife, children or others to whom he stands in loco parentis" in which "equity presumes an intention to make a gift",<sup>129</sup> thus this case should apply the presumption of a resulting trust. Lord Browne-Wilkinson said:<sup>130</sup>

Where the presumption of resulting trust applies, the plaintiff does not have to rely on the illegality. If he proves that the property is vested in the defendant alone but that the plaintiff

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<sup>128</sup> . [1994] 1 AC 340.

<sup>129</sup> . Ibid, at 372.

<sup>130</sup> . Ibid, at 371.

provided part of the purchase money or voluntarily transferred the property to the defendant, the plaintiff establishes his claim under a resulting trust unless either the contrary presumption of advancement displaces the presumption of resulting trust or the defendant leads evidence to rebut the presumption of resulting trust.

His Lordship continued:<sup>131</sup>

In my judgment the time has come to decide clearly that the rule is the same whether a plaintiff founds himself on a legal or equitable title: he is entitled to recover if he is not forced to plead or rely on the illegality, even if it emerges that the title on which he relied was acquired in the course of carrying through an illegal transaction.

As applied in the present case, that principle would operate as follows. Miss Milligan established a resulting trust by showing that she had contributed to the purchase price of the house and that there was common understanding between her and Miss Tinsley that they owned the house equally. She had no need to allege or prove *why* the house was conveyed into the name of Miss Tinsley alone, since that fact was irrelevant to her claim: it was enough to show that the house was in fact vested in Miss Tinsley alone. The illegality only emerges at all because Miss Tinsley sought to raise it. Having proved these facts, Miss Milligan had raised a presumption of resulting trust. There was no evidence to rebut that presumption. Therefore, Miss Milligan should succeed.

However, the English position cannot be used to decide the cases in which the presumption of advancement applies, because to rebut such a presumption, the illegal purpose will have to be disclosed, as Lord Browne-Wilkinson pointed out:<sup>132</sup>

In cases where the presumption of advancement applies, the plaintiff is faced with the presumption of gift and therefore cannot claim under a resulting trust unless and until he has rebutted that presumption of gift: for those purposes the plaintiff does have to rely on the underlying illegality and therefore fails.

The reasons of the decision in *Tinsley v Milligan*<sup>133</sup> may lie in following aspects. First, the policy against the unjust enrichment of the appellant, Miss Tinsley, outweighed the

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<sup>131</sup> . Ibid, at 376.

<sup>132</sup> . Ibid, at 375.

policy of not enforcing the resulting trust because of the respondent's (Miss Milligan's) illegal purpose in concealing by means of the trust her lack of entitlement to the benefit claims. Second, although the respondent had carried out the illegal purpose, she subsequently repented of the frauds and disclosed them to the Department of Social Security. Although the beneficial title of the respondent to the lodging house was upheld, however, the judgment was rejected in Australia.

### **2.5.1.3 The Australian position**

In Australia, the position in relation to the creation of a trust for the implementation of an illegal purpose is this: if the illegal purpose has not carried out wholly or partly, the trust can be enforced;<sup>134</sup> if the illegal purpose has been carried out, the trust can be still enforced, but it is subject to a condition under which the beneficiary shall disgorge the benefits obtained in execution of the illegal purpose.<sup>135</sup>

In *Nelson v Nelson*,<sup>136</sup> a mother paid the purchase price for a house which was transferred into the name of her son and daughter for the purpose of obtaining a subsidy under the *Defence Service Homes Act 1918* (Cth) to buy another house, in that the mother would be not eligible for a subsidy under the Act if she owned another house. She obtained the subsidy and bought the second house by falsely declaring that she had not had any house or any interests in such house other than the second one. After the first house had been sold, a dispute arose in respect of the proceeds of the sale. The mother and her son sought a declaration that the balance of the proceeds of sale was held on

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<sup>133</sup> . [1994] 1 AC 340.

<sup>134</sup> . *Payne v McDonald* (1908) 6 CLR 208.

<sup>135</sup> . *Nelson v Nelson* (1995) 184 CLR 538.

<sup>136</sup> . *Ibid.*

resulting trust for the mother, while the daughter sought a declaration that she had a beneficial interest in the proceeds of the sale.

In that case, there were two issues. First, was the presumption of advancement or the presumption of resulting trust to be applied to the case? Second, if the former presumption is applied, can the presumption be rebutted? With respect to the first question, it was held unanimously that the presumption of advancement applied in the case of gifts by a mother to a child. Thus in this case the presumption of advancement rather than the presumption of resulting trust should be applied. Dawson J said:<sup>137</sup>

In my view, the Court of Appeal was correct in concluding that, in accordance with its previous decision in *Brown v Brown*, the presumption of advancement should now be regarded as applying in the case of gifts by a mother, as well as a father, to a child.

With respect to the second question, it was held that the presumption of advancement could be rebutted by the evidence of the mother's intention to hold the beneficial interest herself. However, this rebuttal is subject to a condition under which the mother shall be denied the benefit obtained by her unlawful conduct. In other words, although the presumption of advancement was rebutted and the resulting trust was upheld, it was conditional because Mrs Nelson had to disgorge the benefit she illegally obtained. The Court held that if on or before 9 January 1996 Mrs Nelson repaid to the Commonwealth an amount equal to the sum of the benefit received in respect of her purchase of the second house, then her daughter's solicitors would hold the whole balance of the proceeds of sale of the first house, together with any interest earned thereon, upon trust for her; and that if Mrs Nelson failed to pay the specified amount by that specified date,

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<sup>137</sup> . Ibid, at 574.

the solicitors should hold that specified amount for her daughter and the remainder of the balance of the proceeds of sale for Mrs Nelson.<sup>138</sup>

Regarding the imposition of this condition, Dawson and Toohey JJ dissented. They were more lenient than the majority of the Court. They held that the resulting trust could be upheld without subject to a condition in that it was the Commonwealth to decide whether or not recover the subsidy from Mrs Nelson and the Court should not order her to pay the benefit back. Dawson J said:<sup>139</sup>

The mother is, on the view which I have expressed, entitled to the relief which she seeks and I see no reason to place conditions upon granting it. The Commonwealth may or may not wish to recover the amount of the subsidy from the mother and to do so wholly or in part or upon terms. That is a matter for the Commonwealth and I do not think that it is any part of the Court's function to assist it in these proceedings to which it is not a party.

Toohey J also dissented by saying:<sup>140</sup>

To require Mrs Nelson, as a condition of obtaining a declaration of beneficial interest in the property or the proceeds of its sale, to pay to the Commonwealth an amount equal to the subsidy is to require more than that a plaintiff do equity between the parties.

In *Nelson v Nelson*,<sup>141</sup> the English position established in *Tinsley v Milligan*<sup>142</sup> was rejected. On the one hand, the presumption of resulting trust rather than the presumption of advancement was applied in *Tinsley v Milligan*.<sup>143</sup> To apply the presumption of resulting trust, the transferor can enforce the trust without disclosing the illegal purpose so long as he/she can prove the facts raising the presumption of the resulting trust. On the other hand, the presumption of advancement cannot be applied in *Tinsley v Milligan*,

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<sup>138</sup> . Ibid, at 572-573 (per Deane and Gummow JJ), at 618-619 (per McHugh J).

<sup>139</sup> . Ibid, at 581-582.

<sup>140</sup> . Ibid, at 598.

<sup>141</sup> . (1995) 184 CLR 538.

<sup>142</sup> . [1994] 1 AC 340.

<sup>143</sup> . Ibid.

because “the outcome in *Tinsley v Milligan* indicates that adoption of one approach rather than the other may lead to opposite results”.<sup>144</sup> In *Tinsley v Milligan*,<sup>145</sup> it was implied that to rebut the presumption of advancement, the transferor had to disclose the illegal purpose behind the transfer. Toohey J said that even taking the approach in *Tinsley v Milligan*, “it was still necessary to consider why Bent Street was not registered in the name of Mrs Nelson” and, he cited Sheller JA in *Nelson v Nelson*<sup>146</sup> ““at that point the purpose of obtaining a subsidised loan by concealment is revealed””.<sup>147</sup> His Honour continued to criticize the approach taken in *Tinsley v Milligan* by saying that it “represents a triumph of procedure over substance. It pays no regard to the nature or seriousness of the illegality”.<sup>148</sup>

According to the view of the High Court Justices, whether the presumption of advancement can be rebutted or not depends on the real intention of Mrs Nelson. Toohey J upheld the view of Handley JA in the Court of Appeal that “any attempt by a disponent to rebut the presumption [of advancement] involves an inquiry as to his or her real intention before and at the time of the disposition”.<sup>149</sup>

Dawson J also said that “both the presumption of a resulting trust and the presumption of advancement may be rebutted by showing the actual intention of the parties”.<sup>150</sup>

It is true that the real implied intention should be the decisive element to determine whether or not a resulting trust should be imposed, and, in *Nelson v Nelson*,<sup>151</sup> the

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<sup>144</sup> . (1995) 184 CLR 538, at 558.

<sup>145</sup> . [1994] 1 AC 340.

<sup>146</sup> . (1994) 33 NSWLR 740.

<sup>147</sup> . (1995) 184 CLR 538, at 558, at 591.

<sup>148</sup> . *Ibid*, at 592-593.

<sup>149</sup> . *Ibid*, at 591.

<sup>150</sup> . *Ibid*, at 580.

presumption of advancement was rebutted because there is no gift was intended.<sup>152</sup> However, except for the real intention that Mrs Nelson did not make a gift, to illegally obtain the subsidised loan was also a real and direct intention of Mrs Nelson. To illegally obtain the subsidised loan was the aim and to vest the house in the names of Mrs Nelson's daughter and son was the means to achieve the aim. Clearly, if the house was not transferred to her daughter and son, Mrs Nelson would not have obtained the subsidised loan. The two real intentions, namely illegally obtaining the subsidy and making no gift, of Mrs Nelson are correlated. If Mrs Nelson wanted to rebut the presumption of advancement, she had to prove that she did not intent to make a gift. To prove she did not intent to make a gift, she had to disclose her illegal purpose. She had to say that the reason she transferred the house in the name of her daughter and son for the purpose of obtaining illegally the subsidised loan.

Once the illegal purpose has been disclosed, the public policy has to be considered. It is the real reason why the Australian High Court held that Mrs Nelson must be put in a position in which her enforcement of the resulting trust is subject to the condition of disgorging the benefit she had obtained illegally.

## **2.5.2 Legality of Trusts under the Civil Law**

Under the Civil Law, it is required that the purpose of a trust cannot violate the law or public policy, or the trust will be void or set aside.

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<sup>151</sup> . (1995) 184 CLR 538.

<sup>152</sup> . Ibid, at 580 (per Dawson J).

### **2.5.2.1 Trusts for illegal purpose or purposes**

A trust is a juristic act, so, its purpose must be lawful. This is the basic principle of civil law. Because article 90 of the Japanese *Civil Code* provides that “a juristic act of which the object is a matter contrary to public policy and good morals is void”, the Japanese *Law of Trusts* does not provide repeatedly that the purpose of a trust is void if its purpose is in violation of law or public policy. However, unlike that of Japan, the trusts law in South Korea, Taiwan and China re-enact the provisions in their civil laws by providing that where the purpose or purposes of a trust violate the law or the public policy, the trust is void.<sup>153</sup> For example, article 71 of the *Civil Code* of ROC provides: “A juristic act which is contrary to an imperative or prohibitive provision of law is void”, and article 72 of the *Law* provides: “A juristic act which is contrary to public order or good morals is void”. Similarly, article 5 (1) and (2) of the *Law of Trusts* of ROC respectively provides that a trust act shall be void if its purpose is contrary to “an imperative or prohibited provision of law” or “good morals”.

With respect to the question whether or not other parts of a trust are valid if only a part of it violates the law or public policy, the South Korean *Law of Trusts* confirms the validity of the parts of trust which do not contravene the law or public policy. Article 5 (3) of this *Law* provides:

Where the purpose or purposes of a trust are in violation of the preceding two paragraphs, if there is any other purpose or purposes of the trust which does not violate the preceding two paragraphs and can be separated from the purpose or purposes violating the preceding two paragraphs, the trust can be created validly for such lawful purpose or purposes. However, although the purpose which does not violate the preceding two paragraphs can be separated from those which have

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<sup>153</sup> . The South Korean *Law of Trusts*, article 5 (1) and (2); the Chinese *Law of Trusts*, article 11 (1) and (6); the *Law of Trusts* of ROC, article 5 (1) and (2).

violated the preceding two paragraphs, the trust is still void if such purpose which does not violate the preceding two paragraphs is obviously against the will of the settlor or the testator.

The Chinese *Law of Trusts* does not clearly answer the question. However, article 60 of the Chinese GPCL provides that “where part of a juristic act is void and it shall not affect the validity of other parts, the other parts of the juristic act are valid”.<sup>154</sup> Thus, if part of a trust which is void does not affect the validity of other parts of the trust, other parts of the trust are still valid.

The *Civil Code* of Taiwan and Japan do not provide the partial validity of a juristic act, so a trust shall be void so long as it is contrary to law or public policy.

In the light of article 58 (2) of the Chinese GPCL, “a void juristic act has no legally binding force *ab initio*”. Because the legal system of resulting trust is not recognized by the Civil Law, the properties obtained by the parties to the invalidated trust shall be returned in accordance with the provisions of civil law after a trust is determined to be void. Article 61 of the Chinese GPCL provides:

- (1) Where a civil juristic act is void or avoided, the properties obtained under the act shall be returned. The party who was at fault shall compensate the other party for the losses it suffered as a result of the act; where both of the parties were at fault, each party shall bear his/her corresponding liability.
- (2) Where the parties have collude maliciously to perform a civil juristic act which is detrimental to the interests of the state, a collective or a third party, the properties they have thus obtained shall be recovered and turned over to the state or the collective, or returned to the third party.

Accordingly, there are three legal consequences after a trust is determined to be void or is avoided, namely to return the property to the settlor or the testator, to compensate other party for the losses caused by the party at fault, and to recover the properties

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<sup>154</sup> . See also article 56 of the Chinese *Contract Law* which stipulates the same provision.

obtained by the parties in malicious collusion so as to reimburse the prejudiced state, collective or a third party.

### **2.5.2.2 Trusts to circumvent the law**

Sometimes a person does not directly violate the law to achieve his/her aim. Instead, he/she circumvents the law to achieve the aim indirectly. This case is called the act to circumvent the law. Because such act circumvents the imperative or prohibited provision of law, it is void.

Although the Japanese *Law of Trusts* leaves a trust which is contrary to law or public policy to be subject to the provisions of the Japanese *Civil Code*, it provides that a trust cannot be created to circumvent legal provisions. Article 10 of the Japanese *Law of Trusts* provides:<sup>155</sup>

Any person who is debarred by law from holding a certain property right shall not, as a beneficiary of a trust, enjoy the same benefits as are derived from holding such right.

The purpose of the *Law of Trusts* of Japan, South Korea and Taiwan for providing that a person who is debarred by law from holding a certain property right can not enjoy such right as a beneficiary of a trust is to prevent such person from achieving the aim of holding such property right by the device of a trust. For example, article 17 of the *Land Law* of ROC provides that “land with trees, land with water for fishing, land with animals for hunting, land with salt, land with minerals, land with freshwater, and land adjacent to military bases and border cannot be transferred, leased or set up incumbrances to any alien”. Thus, any trust which is created for the benefit of an alien to enjoy such rights prescribed by article 17 of the *Land Law* of ROC shall be void.

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<sup>155</sup> . See also the South Korean *Law of Trusts*, article 6; the *Law of Trusts* of ROC, article 5 (4).

The Chinese *Law of Trusts* does not follow its counterparts of Japan, South Korea and Taiwan to stipulate such a provision. This may have been for the following three reasons. First, both an act to violate law and an act to circumvent law are illegal, so it is not necessary to provide them separately. Secondly, it is possible that many trusts may be created to circumvent the law, so it is not enough to stipulate only one provision to prevent such illegal act. Thirdly, because the Chinese GPCL has provided generally that those acts which circumvent law are void, it would be redundant to provide such a term in the Chinese *Law of Trusts*. For example, article 57 (7) of the Chinese GPCL provides that “a juristic act for an illegal purpose but concealed in a lawful form is void”. That means the parties to a juristic act fictitiously undertake a lawful act for the purpose of achieving certain consequences that are debarred by law or violate public policy.

### **2.5.2.3 Trusts for litigation**

A trust which is created for the purpose of litigation shall be void. Article 11 of the Japanese *Law of Trusts* provides:<sup>156</sup>

No trust shall be created, making it its principal purpose to cause acts of litigation to be done.

In addition to providing that a trust created for the purpose of litigation is void, the trusts law in Taiwan and China respectively provide that a trust shall not be valid for the purpose of petitions and for the purpose of demanding repayment of debts. Article 5 (3) of the *Law of Trusts* of ROC provides that “a trust created for the purpose of litigation or petition shall be void”, while article 11 (4) of the Chinese *Law of Trusts* provides that “a trust created for the purpose of litigation or demanding the repayment of debts shall be void”.

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<sup>156</sup> . See also the South Korean *Law of Trusts* article 7.

In the Asian Civil Law countries, people are encouraged to solve their disputes by mediation rather than litigation. The legislative reason of this provision is mainly to discourage people from bringing their disputes into courts and to prevent the abuse of the processes of litigation.

However, it is thought that it is not convincing to stipulate that a trust cannot be created merely for the purpose of litigation, because the litigious rights of people are rights given to people by Constitutions<sup>157</sup> and they are a component of basic human rights. The execution of litigious rights should not be denied on a pretext such as preventing an abuse of the right. It is the right of a person to perform his/her litigious right either by him/herself or by entrusting another person to exercise such right on behalf of him/her. Since a person can entrust a lawyer to exercise his/her litigious right, why he/she cannot transfer his/her property to a lawyer who holds it on trust for the purpose of performing certain litigious rights? Thus, to provide that a trust for the purpose of litigation is void is arbitrary and against the constitutional human rights.

So also, with respect to a trust created for the purpose of petition, it is not appropriate to deny the validity of such a trust. According to article 16 of the *Constitution* of ROC, people can present petition against the administrative decisions or penalties given by administrative department. Petitions are administrative remedies in nature, so they should be protected and cannot be denied by law.

Regarding article 11 (4) of the Chinese *Law of Trusts*, it is also thought that there are no grounds to invalidate a trust created for the purpose of demanding the repayment of debts. Demanding the repayment of debts is the right of a creditor, and such a right cannot be denied by law. In China, demanding the repayment of debts has become a kind

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<sup>157</sup> . The *Constitution* of ROC, article 16, article 33 (3) and article 41.

of business. It can be said that one of the major businesses of a law firm is to demand the repayment of debts on behalf of the creditors. In addition, some corporations are set up especially for doing such business. For example, China Hua Rong Assets Management Corporation (hereinafter called Hua Rong) was specially set up in 1999 to demand repayment of loans on behalf of the largest bank of China, the China Industrial and Commercial Bank.<sup>158</sup>

Therefore, it is suggested that article 11 (4) of the Chinese *Law of Trusts* should be repealed. If the excessive and unnecessary litigation should be prohibited in China, it can be achieved by enacting administrative regulations to limit the trustees who carry out the trusts for the purpose of litigation to those with certain qualifications. For example, an administrative rule can be enacted to prescribe the qualification for the trustees who hold property on trust for the purpose of litigation or demanding the repayment of debts to certain individuals, such as lawyers, and certain legal persons, such as law firms or trust companies.

#### **2.5.2.4 Trusts to defraud creditors**

The law of trusts under the Civil Law jurisdictions provides that a trust which prejudices the creditor of the settlor or the testator shall be set aside by the court on the application of the creditor. Article 12 of the Japanese *Law of Trusts* provides:<sup>159</sup>

- (1) In cases where an obligor has created a trust, knowing it to be prejudicial to his obligee, the obligee may exercise the right of avoidance provided for in Article 242 paragraph 1 of the Civil Code, even if the trustee is *bona fide*.
- (2) The avoidance made pursuant to the provisions of the preceding paragraph shall not affect the benefits which the beneficiary shall have already received, provided however, that this shall

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<sup>158</sup> . Retrieved from the website of Hua Rong Company, <http://www.chamc.com.cn/jianjie/jie1.htm>.

<sup>159</sup> . See also the South Korean *Law of Trusts*, article 8; the *Law of Trusts* of ROC, article 6 (1) and (2).

not apply where the obligation in favour of the beneficiary is not yet due, or where the beneficiary knew, or did not know through gross negligence, at the time the beneficiary received the benefits, the fact that it would be prejudicial to the obligee.

According to the second paragraph of this article,<sup>160</sup> the beneficiary who has already received the benefits shall be a *bona fide* beneficiary. If the beneficiary knew or did not know through gross negligence that the trust was prejudicial to the obligee when he/she received the benefits, he/she could not enjoy the benefits.

In China, article 12 of the Chinese *Law of Trusts* provides:

- (1) Where a trust has prejudiced the creditor of the settlor/testator, the creditor can apply the court to avoid it.
- (2) The avoidance made by the court according to the preceding paragraph shall not affect the benefits which the beneficiary has already received.
- (3) The right of avoidance prescribed by the first paragraph of this article shall be extinguished within one year from the date when the creditor does not exercise the right after he/she knows or should know the fact of prejudice.

Like the *Law of Trusts* of Japan, South Korea and Taiwan, the Chinese *Law of Trusts* indiscriminately provides that a trust can be avoided so long as it is prejudicial to the creditor of the settlor or the testator, rather than distinguish whether the intention of the settlor or the testator is to defraud the creditor. Likewise, article 12 (2) of the Chinese *Law of Trusts* provides that the benefits has been already acquired by the beneficiary shall not affect by the avoidance rather than distinguish whether the beneficiary has acquired the benefits in good faith or in bad faith.

It is important to ascertain the intention of the settlor or the testator, because sometimes a trust which is prejudicial to the creditor of the settlor or the testator may not

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<sup>160</sup> . Article 8 (2) of the South Korean *Law of Trusts* and article 6 (2) of the *Law of Trusts* of ROC are the same.

be created intentionally to defraud the creditor. For example, a divorced man transfers his property to his ex-wife in trust for the benefit of his two young children. This trust may prejudice his creditor, but his intention is to perform his legal duty to support his young children rather than to prejudice his creditor. In this case, if the value of the trust property is reasonable to perform his duty of support, the trust will not be set aside.

Thus, it is suggested that a trust which can be avoided provided by article 12 (1) of the Chinese *Law of Trusts* should only refer to that which is created for the purpose of defrauding the creditor.

With respect to article 12 (2) of the Chinese *Law of Trusts*, it is likely to encourage people to circumvent legal provisions by creating a trust to defraud their creditors because the benefits the beneficiary has received are protected even where the beneficiary had known that the trust would have prejudiced the creditor of the settlor or the testator before he/she received the benefits.

It is suggested that it should be more reasonable to provide, as provided in 12 (2), 8 (2), and 6 (2) of the *Law of Trusts* of Japan, South Korea, and Taiwan respectively, that only a beneficiary in good faith can retain the benefits he/she has already received. If the beneficiary knows or should have known that the trust is prejudicial to the creditor of the settlor or the testator, the benefits he/she has received should be surrendered. That is to say that if the property of the settlor or of the testator cannot be used to pay the creditor fully, the beneficiary should disgorge the benefits he/she has received to pay the creditor. If there is remainder left after the creditor has been paid, the remainder of the benefits can be enjoyed by the beneficiary.

# Chapter 3

## Trust Parties

In the light of the definition of a trust under the Common Law, a trust is a fiduciary relationship between a trustee and the beneficiary,<sup>1</sup> so the parties to a trust are the trustee and the beneficiary. The creator of the trust is excluded as a party to the trust because, if it is a testamentary trust, the trust comes into effective on the death of the testator/testatrix, while if it is an express trust *inter vivos*, the settlor cannot interfere with the trust property and the act of the trustee unless he/she has reserved such rights in the trust instrument. However, under the Civil Law jurisdictions, all of the settlor, the trustee and the beneficiary are regarded as the trust parties to a trust in that the settlor has as many rights as that of the beneficiary except for the beneficiary's entitlement to the beneficial interest.

### 3.1 The Trustee

The trustee is the only essential party to a trust. A trust may exist without a settlor, such as a constructive trust, or without the beneficiary, such as a charitable trust, but it cannot exist without a trustee. Although a trust may not fail for want of a trustee, but it has to have a new trustee appointed to keep the trust alive.

For the purpose of administering a trust, a trustee will be granted certain powers to manage and dispose of the trust property either by the general law or by the trust

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<sup>1</sup> . See section 2 of the *Restatement of Trusts 2d*; Denis Ong: *Trusts Law in Australia* (2003, 2<sup>nd</sup> ed), p 4; Ford and Lee: *Principles of the Law of Trusts* (1996, 3<sup>rd</sup> ed), para [1000]; Michael Evans: *Outline of Equity and Trusts* (1996, 3<sup>rd</sup> ed), p 215; Jill E. Martin: *Modern Equity* (1997, 15<sup>th</sup> ed), p 45; Meagher and Gummow: *Jacobs' Law of Trusts in Australia* (1997, 6<sup>th</sup> ed), para 101.

instrument. He/she is also under a duty to do or not to do certain acts required either by law or by the trust instrument. The duties to perform certain acts may be called positive duties, while the duties prohibiting the trustee from doing some acts may be called negative duties. The trustee must not breach these duties; otherwise he/she will suffer certain legal consequences, namely liabilities. However, a trustee also enjoys some rights, such as the right of indemnity.

Where a settlor or a testator has failed to appoint a trustee under certain circumstances, the trust will not fail for want of a trustee and an original trustee will be appointed. A trustee may retire, resign or be removed from the trustee's office after he/she has accepted the post by virtue of certain reasons. Once the retirement, the resignation or the removal of the trustee arises, a new trustee will be appointed.

Therefore, the law relating to the duties, powers, rights, liabilities, and the appointment of a trustee is the core of the law of trusts under both the Common Law and the Civil Law.

### **3.1.1 Duties of a Trustee**

Once a trustee accepts a trust, he/she has been put into the position in which he/she must administer the trust for the paramount benefit of the beneficiary. The duties of a trustee arise from administering the trust property for the maximum benefit of the beneficiary. Under the Common Law, because a trustee is a fiduciary, he/she is bound by the basic duties of a fiduciary in addition to the specific duties of a trustee. Because there is no fiduciary law under the Civil Law, the basic duties of a trustee under the Civil Law mainly stem from civil law principles. In addition, since trusts law is a special law under the Civil Law, a trustee will also have specific duties prescribed by that trusts law.

### **3.1.1.1 Duties of a trustee under the Common Law**

The duties of a trustee are specifically provided for by sections from 169 to 185 of topic 2, chapter 7 of the *Restatement of Trusts 2d* as follows: “duty to administer the trust; duty of loyalty; duty not to delegate; duty to keep and render accounts; duty to furnish information; duty to exercise reasonable care and skill; duty to take and keep control; duty to preserve the trust property; duty to enforce claims; duty to defend actions; duty to keep trust property productive; duty to pay income to beneficiary; duty to deal impartially with beneficiaries; duty with respect to co-trustees; duty with respect to person holding power of control”.

All these duties stem from the fact that the relationship between the trustee and the beneficiary is a fiduciary relationship and the ultimate duty of a trustee is to administer the trust property for the benefit of the beneficiary. Thus, as a fiduciary, in whom property has been vested, the trustee will be under a duty of care with respect to administering the trust property and the duty of loyalty with respect to the beneficiary.

#### **3.1.1.1.1 The duty of care**

The duty of care requires the trustee to administer the trust property with care. The general principles of the duty of care were established in *In re Speight*<sup>2</sup>. In that case, Jessel MR observed:<sup>3</sup>

It seems to me that on general principles a trustee ought to conduct the business of the trust in the same manner that an ordinary prudent man of business would conduct his own, and that beyond that there is no liability or obligation on the trustee. In other words, a trustee is not bound because he is a trustee to conduct business in other than the ordinary and usual way in which similar

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<sup>2</sup> . (1883) 22 Ch D 727.

<sup>3</sup> . Ibid, at 739-740.

business is conducted by mankind in transactions of their own. It never could be reasonable to make a trustee adopt further and better precautions that an ordinary prudent man of business would adopt, or to conduct the business in any other way. If it were otherwise, no one would be a trustee at all.

This observation of Jessel MR was affirmed on appeal to the House of Lords in *Speight v Gaunt*<sup>4</sup> and the decision in the House of Lords was followed by the Australian High Court in *Austin v Austin*.<sup>5</sup>

Thus, the duty of care requires a trustee to “conduct the business of the trust in the same manner that an ordinary prudent man of business would conduct his own”. However, the standard of the duty of care established by Jessel MR in *In re Speight*<sup>6</sup> was raised as well as lowered by Lindley LJ *In re Whiteley*.<sup>7</sup> There his Lordship said:<sup>8</sup>

The duty of a trustee is not to take such care only as a prudent man would take if he had only himself to consider; the duty rather is to take such care as an ordinary prudent man would take if he were needed to make an investment for the benefit of other people for whom he felt morally bound to provide.

In essence, the standard of care laid down by Lindley LJ requires a trustee not only take such care as a prudent person would take, but also to “take such care as an ordinary prudent man would take if he were needed to make an investment for the benefit of other people”. To require a trustee act in a manner of a prudent person focuses on the objective and external element of the trustee in administering the trust property, while to require a trustee to act as “if he were needed to make an investment for the benefit of other people” focuses on the subjective and internal element of the trustee which is the requirement of conscience. In this sense, the standard of the duty of care was raised.

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<sup>4</sup> . (1883) 9 App Cas 1.

<sup>5</sup> . (1906) 3 CLR 516.

<sup>6</sup> . (1833) 22 Ch D 727.

<sup>7</sup> . (1886) 33 Ch D 347.

<sup>8</sup> . *Ibid*, at 355.

However, in *In re Whiteley*, Lindley LJ also, perhaps as a result of an oversight, lowered the standard of “an ordinary prudent man of business” to “an ordinary prudent man”. It is obvious that an ordinary prudent “man of business” is distinct from an ordinary prudent “man”. Although “a man of business” should not be construed as a professional trustee, neither should he/she be construed as an ordinary prudent man. Such a man should be construed as a man who conducts trust affairs as his own business. In other words, a man of business shall be under a duty to do his best to avoid any losses to the trust property.

It is noteworthy that, with respect to the deposit by the trustee of trust money or securities with other persons, the standard of the duty of care is lowered by some of statutes in Australia. In New South Wales, Victoria, Tasmania and Western Australia, the legislation in these states provides that a trustee is only liable for the loss of trust property which he/she deposits with other persons carelessly in the case where his/her default is wilful. For example, section 70 of the *Trustee Act 1962* of Western Australia provides:

A trustee shall be chargeable only for money and securities actually received by him, notwithstanding his signing any receipt for the sake of conformity; and shall be answerable and accountable only for his own acts, receipts, neglects or defaults, and not for those of any other trustee, nor those of any bank, broker or other person with whom any trust money or securities may be deposited, nor for the insufficiency or deficiency of any securities, nor for any other loss, unless the insufficiency, deficiency or loss occurs through his own wilful default.

Whilst in Queensland, if a trustee deposits trust property with other persons carelessly, he/she will be liable for breach of the duty of care so long as he/she deposits the trust property in default as opposed to wilful default. Section 71 of the *Trusts Act 1973* (Qld) provides:

A trustee shall be chargeable only for money and securities actually received by the trustee, notwithstanding the trustee signing any receipt for the sake of conformity; and shall be answerable and accountable only for his own acts, receipts, neglects or defaults, and not for those of any other trustee, nor those of any bank, broker or other person with whom any trust money or securities may be deposited, nor for the insufficiency or deficiency of any securities, nor for any other loss, unless the insufficiency, deficiency or loss occurs through his own default.

In South Australia, section 35 (1) of the *Trustee Act 1936* (SA) uses the terms “wilfully or negligently” to replace the term “default” adopted in the Queensland legislation and the term “wilful” adopted in the other four states of Australia. Although section 35 (1) of the *Trustee Act 1936* (SA) uses the terms “wilfully or negligently” which are different from the term “default” in section 71 of the *Trusts Act 1973* (Qld), because of the wording “or negligently”, the standard of the duty of care adopted by South Australia is in essence the same as that adopted in Queensland. Both of the two states do not modify the trustee’s duty of care as a fiduciary.

The general principle of the duty of care should be only applied to non-professional trustees. In respect of professional trustees, a higher duty of care is imposed on them. The higher duty of care imposed on a professional trustee was laid down in *Bartlett v Barclays Bank Trust Co Ltd (No 1)*.<sup>9</sup> In that case, it was held that “where a trustee, such as a trust corporation, held itself out as having the skill and expertise to carry on the specialised business of trust management, the duty of care of such a trustee was higher than the standard of care of the ordinary prudent man of business as demanded of a trustee without specialised knowledge”.<sup>10</sup>

Generally, the duty of care comprises the following specific duties.

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<sup>9</sup> . [1980] 1 Ch 515.

<sup>10</sup> . Ibid, at 516.

### ***The duty to familiarise himself/herself with the terms of the trust***

The duty of care begins with the duty of a trustee to familiarise himself/herself with the terms of the trust. After a trustee has accepted a trust, he/she must clearly understand the terms of the trust and all the documents and deeds relating to the trust.<sup>11</sup> He also should know clearly the nature and the circumstances of the trust property and what he/she is required to know in respect of the trust property.<sup>12</sup> Understanding thoroughly the terms and the property of the trust, the trustee can carry out the trust in accordance with those terms. This duty of the trustee to familiarise himself/herself with the terms of the trust is the prerequisite of administering trust property for the benefit of the beneficiary.

### ***The duty to get in and preserve the trust property***

To get in and to preserve the trust property is also a part of the duty of care. Since a trustee has familiarised himself/herself with the terms of the trust and the trust property, he/she is under the duty to get into his/her possession all the trust property which he has not actually possessed. In getting in the trust property, the trustee's possession may differ as between different properties. If the trust property is a chattel, he/she should take control of it; if the property is land, he/she should get the title of land registered under his/her name; if the trust property is a chose in action, he/she should take necessary steps to be paid. Again, a trustee can also get in the trust property by himself/herself or by entrusting an agent because the trustee does not need to get into possession of all the trust property.

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<sup>11</sup> . *Hallows v Lloyd* (1888) 39 Ch D 686 at 691.

<sup>12</sup> . *Harvey v Olliver* (1887) 57 LT 239 at 241.

With respect to the trust property possessed by a trustee, the trustee is under the duty to preserve it in case of loss or damage. The term “preserve” is a broad concept. The duty to preserve trust property requires a trustee to take care of the trust property for the benefit of the beneficiary. It includes the conservation or deposit, maintenance, repair and improvement of the trust property with care. It should also include insuring the trust property.

In America, the illustration 3 to section 176 of the *Restatement of Trusts 2d* makes the taking out fire insurance as a duty of a trustee by giving an example which reads:

A is trustee of a house. He fails to take out fire insurance upon the house, although such insurance is customarily taken by prudent men. The house burns. He is liable for the loss.

It is ordinarily the duty of the trustee to bring such actions as are reasonably necessary for the protection of the trust estate.

In Australia, to insure trust property is usually regarded by legislation as a power rather than a duty of a trustee. For example, section 47 (1) of the *Trusts Act 1973* (Qld) provides:<sup>13</sup>

A trustee may insure against loss or damage, whether by fire or otherwise, any insurable property, and against any risk or liability against which it would be prudent for a person to insure if the person were acting for himself or herself.

However, in New South Wales, in *Pateman v Heyen*,<sup>14</sup> it was held that the trustee of a deceased estate has a duty to insure the trust property.

### ***The duty to keep the trust property separate and to keep proper accounts***

A trustee, apart from under the above duties, is also under the duty to keep the trust property separate and to keep proper accounts. The duty to keep trust property separate

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<sup>13</sup> . See also: *Trustee Act 1962* (WA), s 30 (1) (g); *Trustee Act 1958* (Vic), s 23; *Trustee Act 1936* (SA), s 25; *Trustee Act 1925* (NSW), s 41; *Trustee Act 1898* (Tas), s 21.

<sup>14</sup> . (1993)33 NSWLR 188 at 197-198 (per Cohen J).

embodies the following three aspects that: the trustee should keep the trust property away from his own property, keep the trust property separate from those held by him upon other trusts, and earmark the property as the trust property.<sup>15</sup>

After a trustee has accepted a trust, he/she should designate the trust property distinctly so that he/she would not mix the trust property with his/her own property. In addition to separating the trust property from those of his/her own, the trustee should not mix the trust property with other non-trust property and with the trust property of other trusts.

To keep proper accounts of the trust property is also a duty of a trustee.<sup>16</sup> If the trustee is not professional to be capable of dealing with complicated accounts, he/she may employ appropriate accountants to keep accounts of the trust property. In the light of section 52 (1) of the *Trusts Act 1973 (Qld)*, “a trustee may, in the trustee’s absolute discretion, from time to time, cause the accounts of the trust property to be examined or audited by a public accountant, and shall for that purpose produce such vouchers and give such information to that person as the trustee may require.”

### **3.1.1.1.2 The duty of loyalty**

Since a trustee, as a fiduciary, administers the trust property solely for the benefit of the beneficiary rather than for the benefit of himself/herself, the trustee is under the duty to the beneficiary to execute the trust with loyalty. The duty of loyalty comprises the following specific duties.

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<sup>15</sup> . *The Restatement of Trusts* 2d, section 179.

<sup>16</sup> . *Freeman v Fairlie* (1817) 3 Mer 27 at 42; 36 ER 12 at 17.

### ***The duty to avoid conflict between the duty and interests of the trustee***

The core element of the duty of loyalty is that the trustee “is not allowed to put himself in a position where his interests and duty conflict”.<sup>17</sup> Thus, to avoid the conflict between the trustee’s duty and his/her personal interests, a trustee is under a duty not to purchase the trust property and not to purchase the beneficiary’s beneficial interests without the latter’s fully informed consent.

### **The duty not to purchase the trust property**

The duty not to purchase the trust property means that a trustee can neither purchase the trust property in the name of another person nor purchase his/her own property as the trust property in the name of the trustee purchaser. This duty is also called “self-dealing rule”. In *Clay v Clay*,<sup>18</sup> the High Court stated:<sup>19</sup>

[T]he “self-dealing rule” is that the sale by the trustee of the trust property to himself is voidable by any beneficiary *ex debito justitiae*, however honest and fair the transaction and “even if [the sale] is at a price higher than that which could be obtained on the open market”.

According to the High Court,<sup>20</sup> the stringent position of the “self-dealing rule” may represent the following several principles. First, at common law, in the case of self-dealing, the contract lacked “intrinsic validity”; there was no contract which could be sued upon, the principle being “that no man can be at the same time plaintiff and defendant”. Secondly, at common law, a person could not convey a freehold estate to himself, nor assign a leasehold term or other personal property, and, in general, choses in action were not assignable; attempted dispositions would be nullities at common law. Thirdly, a

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<sup>17</sup> . *Bray v Ford* [1896] AC 44 at 51.

<sup>18</sup> . (2001) 202 CLR 410.

<sup>19</sup> . *Ibid*, at 434 (per Gleeson CJ, McHugh, Gummow, Hayne and Callinan JJ who delivered a joint judgment).

<sup>20</sup> . *Ibid*.

distinction is to be drawn between conveyances of legal title and the overreaching of beneficial interest in the subject matter of the conveyance. Thus, in equity, these attempted dispositions also would be breaches of trust by the trustee and would not displace or override the interest of the beneficiaries.

In England, the position of the “self-dealing rule is not as stringent as that in Australia, because “the ‘self-dealing rule’ does not apply in its full stringency and the trustee may be allowed to uphold the transaction in question by meeting the more generous criteria of the ‘fair-dealing rule’”.<sup>21</sup>

In *Holder v Holder*,<sup>22</sup> a trustee was allowed to purchase the trust property with the fully informed consent of all the beneficiaries for a fair price. In that case, a testator devised his two farms on trust equally for his widow, eight daughters and two sons. He also appointed his widow, one of his daughters and one of his sons, Victor, as executors. The executors opened up an executor’s account and paid out nine cheques to meet small liabilities of the estate and then Victor renounced his executorship by deed so that he could purchase the farms. He subsequently purchased the farms at a fair price at auction without any objection from any of the executors or beneficiaries at the time of the sale. However, the other son of the testator, who is one of the beneficiary, later objected to the purchase on the footing that Victor should had been prohibited from purchasing the farms as he was an executor.

Harman LJ of the English Court of Appeal held that the general rule against a trustee purchasing trust property is based on two reasons. One is that “a man may not be both vendor and purchaser” and the other is that “there must never be a conflict of duty and

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<sup>21</sup> . Ibid, at 435.

<sup>22</sup> . [1968] 1 Ch 353.

interest”.<sup>23</sup> However, in the very special circumstances of that case he doubted the validity of the general rule. There his Lordship said:<sup>24</sup>

He took no part in the instructions for probate, nor in the valuations or fixing of the reserves. Everyone concerned knew of the renunciation and of the reason for it, namely, that he wished to be a purchaser. Equally, everyone, including the three firms of solicitors engaged, assumed that the renunciation was effective and entitled Victor to bid... My reasons are that the beneficiaries never looked to Victor to protect their interests. They all knew he was in the market as purchaser; that the price paid was a good one and probably higher than anyone not a sitting tenant would give.

Therefore, Harman LJ held that the general rule that a trustee is prohibited from buying trust property could not be applied to that case to disentitle Victor to purchase the trust property.

## The duty not to purchase the beneficiary's beneficial interests

Although the sale by the trustee of the trust property to himself is voidable by any beneficiary no matter how honest and fair the transaction may be, however, there is no such stringent prohibition against a trustee from purchasing a beneficiary's interests in the trust property which is called the “fair-dealing rule”. In *Clay v Clay*,<sup>25</sup> the High Court of Australia stated:<sup>26</sup>

The “fair-dealing rule” provides that a transaction whereby the beneficial interest of a beneficiary is purchased by the trustee is not voidable *ex debito justitiae*, but may be set aside, unless the trustee can show that no advantage has been taken of the position of trustee, that full disclosure has been made to the beneficiary, and that the transaction is fair and honest. Where the trustee meets these burdens, the result is that the interest acquired by the trustee is placed beyond any claim by the beneficiary or those claiming under the beneficiary. ...

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<sup>23</sup> . Ibid, at 391.

<sup>24</sup> . Ibid, at 392.

<sup>25</sup> . (2001) 202 410.

<sup>26</sup> . Ibid, at 434.

Thus, so long as the trustee who has purchased the beneficiary's interests can prove that he/she has taken no advantage by the position of a trustee, he/she has made full disclosure to the beneficiary, and the transaction has been fair and honest, the purchase of the beneficiary's beneficial interest in the trust property is permitted.

### ***The duty to give full information to the beneficiaries***

A trustee is under the duty to inform the beneficiaries all the matters relevant to their interests.<sup>27</sup> To give full information to the beneficiaries, a trustee at first is under the duty to be ready to render accounts of trust property where required by the beneficiaries or by persons authorised by the beneficiaries<sup>28</sup> and under the duty to furnish accounts to the beneficiary.<sup>29</sup>

Secondly, a trustee is under the duty to give the full information as to the amount of the trust property and as to its investments even if the beneficiary's interest is only contingent.<sup>30</sup> The trustee is also bound to give the beneficiary the information as to the condition and location of the trust fund.<sup>31</sup>

In addition, the trustee is under the duty to allow the beneficiaries access to the trust document. The trustee should make the trust documents available to the beneficiary for inspection unless he/she has a satisfactory reason not to disclose them. In *Re Fairbairn*,<sup>32</sup> Gillard J stated:

It seems to me that in this case the beneficiary has quite correctly requested the trustees to make available to him the documents relating to the conduct and management of the pastoral business forming part of the estate left by the deceased.

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<sup>27</sup> . *Low v Bouverie* [1891] 3 Ch 82 at 99 – 100 (per Lindley LJ).

<sup>28</sup> . *Manning v Commissioner of Taxation* (1928) 40 CLR 506.

<sup>29</sup> . *Springett v Dashwood* (1860) 2 Giff 521.

<sup>30</sup> . *Walker v Symonds* (1818) 3 Swan 1, 36 ER 751; *Sawyer v Goddard* [1895] 1 Ch 474 (CA).

<sup>31</sup> . *Low v Bouverie* [1891] 3 Ch 82 at 99 (per Lindley LJ).

<sup>32</sup> . [1967] VR 633.

The beneficiary's right to inspect trust documents was regarded as based on the fact that the beneficiary is the equitable owner of the trust documents and the beneficiary's right to access the trust document is a proprietary right.<sup>33</sup> However, if the right to inspect trust document is a proprietary right, it would become difficult to apply in a discretionary trust, under which the trustee has right not to disclose to the beneficiaries the reasons for the exercise of his/her discretion.

The view that the beneficiary's right to inspect trust document is a proprietary right has been changed now. In *Schmidt v Rosewood Trust Ltd*,<sup>34</sup> it was held that "although a beneficiary's right to seek disclosure of trust documents could be described as a proprietary right, it was best approached as one aspect of the court's inherent and fundamental jurisdiction to supervise and if appropriate intervene in the administration of a trust, including a discretionary trust; that that jurisdiction did not depend on any distinction between transmissible and non-transmissible or discretionary interests, or between the rights of an object of a discretionary trust and those of an object of a mere power of a fiduciary character; and that, accordingly, a proprietary right was neither sufficient nor necessary for the exercise of the court's jurisdiction".<sup>35</sup>

It is thought that in fact, the trustee's duty to allow the beneficiary access to the trust documents stems from the trustee's duty of loyalty. The duty is only a part of the trustee's duty of loyalty. Thus, in a discretionary trust, a trustee, who elects not to disclose the reasons for the exercise of his/her discretion, can be construed as exercising his/her power as a trustee as well as performing his/her duty of loyalty as a trustee.

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<sup>33</sup> . *O'Rourke v Darbishire* [1920] AC 581 at 626 -627 (per Lord Wrenbury)

<sup>34</sup> . [2003] 2 WLR 1442.

<sup>35</sup> . *Ibid*, at 1442.

### ***The duty to act impartially***

Where there are more than two beneficiaries in a trust, the trustee is bound to act impartially between them. He/she cannot act to favour one of the beneficiaries at the expense of another. But, it is very difficult for a trustee to perform this duty in two situations. One is where there are successive beneficiaries, and the other is where the trust is a discretionary trust.

Where there are successive beneficiaries, the beneficiaries hold different beneficial interests, such as when one beneficiary holds the life estate while the other holds the remainder. In this case the trustee must act impartially to ensure that both the life estate beneficiary and the beneficiary in remainder can obtain a reasonable income and corpus respectively.

In a discretionary trust, a trustee, by the terms of the trust, may be entitled to distribute the beneficial interest among beneficiaries with full discretion and he/she may exercise such discretion by favouring one beneficiary over another. In this case, “the court will not control the exercise of such discretion, except to prevent the trustee from abusing it”.<sup>36</sup>

### ***The duty not to delegate***

As a fiduciary, a trustee is under the duty to carry out the trust personally and not to delegate his/her duties or powers to other persons.<sup>37</sup> The delegation cannot be made even

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<sup>36</sup> . The comment on section 183 of the *Restatement of Trusts 2d*.

<sup>37</sup> . *Re Bellamy and Metropolitan Board of Works* (1883) 24 Ch D 387; *Wood v Weightman* (1872) LR 13 Eq 434; *Adams v Clifton* (1826) 1 Russ 297, 38 ER 115.

as between the co-trustees,<sup>38</sup> in that where there are co-trustees, “each individual trustee has a separate responsibility to ensure that the terms of the trust are carried out”.<sup>39</sup>

However, in Australia, legislation in every jurisdiction<sup>40</sup> confers on a trustee the power to delegate his/her duties or powers to others under certain circumstances although the enactments are not identical to each other. For example, according to section 56 (1) of the *Trusts Act 1973* (Qld), a trustee can delegate all or any trusts, powers, authorities, and discretions vested in him/her to any person if the trustee is out of the State, is or may be about to become, by reason of physical infirmity, temporarily incapable of performing all duties of a trustee.

Thus, there are two exceptions to the general rule of the duty not to delegate. One is that the trustee is allowed to delegate his/her duty to others if the trust instrument so authorises; the other is where the delegation is specifically permitted by statute.

However, the trustee’s duty not to delegate does not deny his/her power of appointing an agent or agents.

***The duty to transfer trust property to beneficiaries who together are of full legal capacity and absolutely entitled to trust property***<sup>41</sup>

In *Saunders v Vautier*,<sup>42</sup> the general rule that the beneficiaries who are all of full legal capacity and are absolutely entitled to the property have the right to call for the transfer of the legal title from the trustee to themselves to terminate the trust was established. This rule is also known as the rule in *Saunders v Vautier*. According to the

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<sup>38</sup> . *Re Flower and Metropolitan Board of Works* (1884) 27 Ch D 592; *Eaves v Hickson* (1861) 30 Beav 136, 54 ER 840.

<sup>39</sup> . *Re Mulligan* (decd) [1998] 1 NZLR 481 at 502 (per Panckhurst J).

<sup>40</sup> . *Trusts Act 1973* (Qld), s 56; *Trustee Act 1962* (WA), s 30 (1) (g); *Trustee Act 1958* (Vic), s 23; *Trustee Act 1936* (SA), s 25; *Trustee Act 1925* (NSW), s 41; *Trustee Act 1898* (Tas), s 21.

<sup>41</sup> . See also section 3.2.1.1 “right to extinguish the trust” of this Thesis.

<sup>42</sup> . (1841) 4 Beav 115; 49 ER 282.

rule, where the beneficiaries, who are all of full legal capacity and are absolutely entitled to the trust property, unanimously decide to terminate the trust and require the trustee to transfer the trust property to them, the trustee is bound to transfer the trust property to the beneficiaries.

### ***3.1.1.2 Duties of a trustee under the Civil Law***

Although there is no fiduciary concept under the Civil Law, the duties a trustee is bound to perform are similar to those of a trustee under the Common Law. From the point of view of structure, the duties under the Civil Law can be divided into three levels. The first level, or the highest level, is the overarching duty of a trustee, under which, the trustee is bound to conduct the trust affairs for the optimal interests of the beneficiary. It is a duty in relation to the beneficiary. The second level, or the intermediate level, which concerns the administering the trust property, is the duty which combines loyalty, good faith, care and efficiency. It can be regarded as the sub-overarching duty of a trustee. The third level of duty is the specification of the second level of duties. In other words, the duties at the second level, namely the duty of loyalty, the duty of good faith, the duty of care and the duty of efficiency, comprise the specified duties at the third level. For example, the duty to keep the trust property separate at the third level is under the duty of care at the second level, while the duty not to profit from the trust property at the third level is under the duty of loyalty at the second level. The division of these duties and the duties of the third level are slightly different as between the Civil Law jurisdictions.

### **3.1.1.2.1 The overarching duty of the trustee**

A trustee is under an overarching duty, in accordance with the tenor of the trust, to deal with the trust affairs for the optimal beneficial interest of the beneficiary. This is the general and overarching duty imposed on a trustee, and all the other duties of a trustee are derived from this duty. Article 25 (1) of the Chinese *Law of Trusts* provides:

The trustee shall conduct the trust affairs for the optimal benefit of the beneficiary in accordance with the terms of the trust instrument.

Article 4 of the Japanese *Law of Trusts* also provides that “the trustee shall administer or dispose of the trust property in accordance with the provisions of the act of trust”. Although the law of trusts of South Korea and Taiwan do not provide such an overarching duty, the definitions of the trust given by the laws imply the existence of such a duty.

### **3.1.1.2.2 The sub-overarching duty of the trustee**

The sub-overarching duty of a trustee is the second level of duty for a trustee, which concerns administering the trust property. It is comprised of the duty of loyalty, the duty to act in good faith, the duty of care and the duty of efficiency. Article 25 (2) of the Chinese *Law of Trusts* provides:

A trustee is bound to manage the trust property with loyalty to his/her office, acting in good faith and managing with prudence and efficiency.

This level of duty for a trustee is the peculiar provision of the Chinese *Law of Trusts*. The trusts law in Japan, South Korea and Taiwan do not provide for the similar second level of duties. Rather, the trusts law in these jurisdictions provide for the third level of duties directly.

The former two kinds of duties, the duty of loyalty to his/her office and the duty to act in good faith, are closely related, while the latter two kinds of duties, the duty of care and the duty of efficiency, are also closely related. The specific duties at the third level are to be discussed under the title of the duties at the second level in the following steps.

### **3.1.1.2.3 The duty of loyalty**

In creating a trust, the trustee is entrusted with trust affairs on the basis of confidence, therefore he/she should conduct the trust affairs with loyalty to his office and act in good faith. Specifically, the duty of loyalty comprises the following duties.

#### ***The duty not to enjoy the beneficial interests***

A trustee is under the duty not to obtain the beneficial interest unless he/she is one of the beneficiaries. Article 9 of the Japanese *Law of Trusts* provides:<sup>43</sup>

A trustee shall not enjoy the benefits of trust in the name of any person whomsoever, except where he is one of the co-beneficiaries.

Unlike the Japanese *Law of Trusts*, the Chinese *Law of Trusts* does not specifically impose this duty, because it was suggested that the definition of the trust has lucidly expressed that a trustee must conduct the trust business for the beneficial interest of the beneficiary, not for himself/herself. It seems that it is not necessary for this duty to be expressly imposed.

#### ***The duty to avoid a conflict between the duty and the personal interests of the trustee***

Because the aim of the creation of a trust is to let the beneficiary rather than the trustee enjoy the benefits of the trust, this duty requires the trustee not to put

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<sup>43</sup> . See also the South Korean *Law of Trusts*, article 29; the *Law of Trusts* of ROC, article 34.

himself/herself into a position in which his/her duty of conducting trust affairs and his/her personal interests conflicts or is of the possibility of conflict.

To perform this duty, the Chinese *Law of Trusts* provides that at first a trustee is under the duty not to profit from the trust property. Article 26 (1) of the *Law* provides:

Apart from obtaining the remuneration in accordance with this law, a trustee shall not make use of trust property for his/her own benefit.

Secondly, a trustee is under the duty not to enter into transactions between his/her property and trust property and between trust properties under different trusts held by him/her. Article 28 (1) of the *Law* provides:

A trustee shall not conduct transactions between the trust property and his/her individual property or conduct transactions between trust properties of different trusts, except where it is otherwise provided by trust instruments or where it has been approved by the settlor or the beneficiary, and that such transactions have been made in accordance with fair market price.

The legislative spirit of this article stems from the general principle concerning agency of civil law. According to this principle, an agent cannot engage in self-dealing or double-agent-dealing. For example, article 108 of the Japanese *Civil Code* provides: “No person may, in one and the same juristic act, be an agent of the other party or of both parties; however, this shall not apply in respect of the performance of an obligation”.<sup>44</sup> In addition, article 28 (1) of the Chinese *Law of Trusts* also accepts the legal fruit of the trusts law under the Common Law concerning the self-dealing rule and the fair-dealing rule.

In fact, the provisions of article 28 (1) of the Chinese *Law of Trusts* are similar to the English position established in *Holder v Holder*.<sup>45</sup> Namely a trustee cannot purchase the

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<sup>44</sup> . See also the *Civil Code* of ROC, article 106; the German *Civil Code*, article 181.

<sup>45</sup> . [1968] 1 Ch 353.

trust property unless he simultaneously meets the two requirements: purchasing it at a fair market price and obtaining the consent of the settlor or the beneficiary.

However, the provisions in article 28 (1) of the Chinese *Law of Trusts* have some deficiencies. One is that the trustee can enter a self-dealing transaction at a fair market price and merely with the consent of the settlor. Where a self-dealing occurs, it is the beneficiary rather than the settlor who may be prejudiced by the transaction. So, it is the beneficiary who should decide whether the transaction is valid or not. It is suggested that the self-dealing at a fair market should be valid only with the consent of the beneficiary rather than the settlor, unless the settlor reserves such right in the trust instrument.

The other deficiency is that this article does not prohibit the transactions between the trustee and a third person which will cause the conflict between the trustee's duty and personal interest in the same way as a self-dealing transaction does. Thus, it is suggested that if the transaction between the trustee and a third person will cause the conflict between the trustee's duty and personal interest, the transaction should also be voidable at the instance of the beneficiary.

Furthermore, in respect of the "double-agent-dealing" rule that a trustee cannot enter a transaction between trust properties of different trusts held by him/her, the provisions of this article is not satisfactory. To carry out such transactions does not itself necessarily cause conflict between the trustee's duty and his/her personal interests. Thus, it is suggested that so long as such transactions are made at fair market price, they should be valid even if they are entered without the consent of the settlor or the beneficiary.

Thirdly, a trustee is under the duty not to convert the trust property as his/her own property. Article 27 of the Chinese *Law of Trusts* provides:

A trustee cannot convert the trust property as his/her individual property. Where the trustee has converted the trust property into his/her individual property, he/she must restore the trust property or indemnify the losses caused by him/her.

Because article 28 of the *Law* prohibits a trustee from purchasing the trust property, this article should refer to the rule that a trustee cannot acquire the trust property by any method other than purchasing. However, if the trustee converts the trust property as his/her own property by succession, it cannot be invalidated. Apart from purchase and succession, the only way that a trustee acquires the trust property as his/her own property is conversion or appropriation. Where the conversion is so serious that it constitutes the crime of conversion provided for by articles 270 and 271 of the Chinese *Criminal Law*, the trustee will be liable for his/her crime; where the conversion is not amount to a crime, the trustee will be liable for restitution or indemnification if the conversion has caused the losses to the trust property.

The *Law of Trusts* of Japan, South Korea and Taiwan do not provide that a trustee shall neither make use of the trust property for his own benefit nor enter into transactions which may cause conflict between the trustee's duty and personal interests, but they provide that a trustee shall not convert trust property into his/her own property. Article 22 of the Japanese *Law of Trusts* provides:<sup>46</sup>

- (1) A trustee shall neither make the trust property his/her own property nor acquire any right thereon, in the name of any person whomsoever, provided however, that this shall not apply in cases where the trustee converts the trust property into his own for unavoidable reasons, upon obtaining permission of the Court.

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<sup>46</sup> . See also the South Korean *Law of Trusts*, article 31.

- (2) The provisions of the preceding paragraph shall not preclude the trustee from succeeding to a right on the trust property by inheritance or other universal transmission. In such cases, the provisions of Article 18 shall apply *mutatis mutandis*.

Differently, article 35 (1) the *Law of Trusts* of ROC provides:

- (1) A trustee shall neither convert trust property into his/her own property nor set up or acquire any right thereon, except that:

- (a) it is made at market price and with the consent of the beneficiary;
- (b) it is made by bid in auction; and
- (c) it is made for unavoidable reasons and obtained permission of the court.

In the light of the provisions of article 22, article 31 and article 35 of the *Law of Trusts* of Japan, South Korea and Taiwan respectively, these articles imply and include the duties provided for by articles 26, 27 and 28 of the Chinese *Law of Trusts*. However, the provisions of the Chinese *Law of Trusts* are much clearer.

#### **3.1.1.2.4 The duty of care**

Under the Civil Law, an obligor is liable for his/her acts, whether intentional or due to his/her fault. However, the degree of the duty of care may differ between a gratuitous obligor and an obligor for remuneration.<sup>47</sup> An obligor for remuneration is under a higher duty of care than a gratuitous obligor. Article 406 of the Chinese *Contract Law* provides:

Under a mandate contract for value, if the principal sustains any loss due to the fault of the mandatary, the principal may claim damages. Under a gratuitous mandate contract, if the principal sustains any loss due to the mandatary's intentional misconduct or gross negligence, the principal may claim damages.

Article 535 of the *Civil Code* of ROC also provides:<sup>48</sup>

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<sup>47</sup> . The *Civil Code* of ROC, article 220.

<sup>48</sup> . See also article 590 of the *Civil Code* of ROC. In addition, although article 644 of the Japanese *Civil Code* provides that “a mandatary is bound to manage the affairs entrusted to him with the care of a good manager in accordance with the tenor of the mandate” no matter whether the mandate is or is not

The mandatary is bound to manage the affairs entrusted to him in accordance with the instructions of the principal and to do so with such care as he would exercise over his own affairs. If the mandate is a non-gratuitous one, the affairs must be managed with the care of a good manager.

Nevertheless, in respect of that what constitutes a good manager's care, it is not explained by the *Civil Code* of Japan and Taiwan. According to the scholars from both China and Taiwan, the degree of fault can be divided into three levels.<sup>49</sup> The lowest level of fault is gross negligence, which means in breach of such care that is expected from any ordinary people. Because gross negligence is the lowest duty imposed on an obligor, it cannot be released in advance.<sup>50</sup> The second level of fault is general negligence, which means in breach of such care as an ordinary prudent person would exercise in conducting his/her own business. The highest level is minor fault, which means a breach of the duty to take such care as a good manager would exercise in dealing with his/her own affairs. The term "good manager" is a translation of "*shanliang guanlire*" (善良管理人) in Chinese. "Manager" or "administrator" here is a kind of professional person rather than an ordinary person or an ordinary prudent person. "Good" here means that the manager should act in good faith. Thus, where an obligor is under a good manager's duty of care, it means he/she must exercise such care in good faith as a professional manager would exercise in dealing with the properties entrusted to him/her.

Borrowing the obligor's the duty of care as prescribed by the *Civil Code* of Japan, South Korea, and Taiwan; the *Laws of Trusts* of the three jurisdictions also impose on a

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gratuitous, article 659 of the *Law* provides that "a gratuitous bailee shall use the same care in the custody of the thing bailed as he uses in respect of his own property".

<sup>49</sup> . Jiang Ping (ed): *The Civil Law* (2000), p 491; Shi Tiantao & Yu Wenran: *The Law of Trusts* (1999), p 123.

<sup>50</sup> . Article 222 of the *Civil Code* of ROC provides: "Liability for intentional acts or gross negligence cannot be released in advance".

trustee a good manager's duty of care. Article 20 of the Japanese *Law of Trusts* provides:<sup>51</sup>

A trustee shall manage trust affairs with the care of a good manager in compliance with the tenor and purpose of the trust.

It is clear that the degree of the duty of care under the above Civil Law jurisdictions imposed on a trustee is higher than that imposed on a trustee under the Common Law jurisdictions. Indeed, the care which a "good manager" exercises is greater than the care which an ordinary prudent man of business exercises in dealing with his own property.

The duty of care is a general provision. With respect to the question as to what the contents of the duty of care are, it can only be judged by the court according to all the circumstances relating to the trustee's management.

The Chinese *Law of Trusts* does not impose on a trustee such a duty of care like the *Law of Trusts* of Japan, South Korea and Taiwan do. With giving the sub-overarching duty of a trustee, the provisions of article (2) of the Chinese *Law of Trusts* do not impose on the trustee the duty of a good manager, but only the duty of a prudent person. However, the meaning of the term "prudence" itself is not exact, so the question as to what is the standard of prudence arises.

Before the enactment of the Chinese *Law of Trusts*, article 24 of the Second Draft of the Law provided that "the trustee is under a duty of care which would be the same as the care with which an ordinary person manages and disposes of his/her own property". It was thought as low as the duty of care that a mandatary bears under a mandate contract. However, the duty of care as a good manager under the *Law of Trusts* in Japan, South Korea and Taiwan was thought as too high to be adopted in China.

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<sup>51</sup> . See also article 28 of the South Korean *Law of Trusts* and article 22 of the *Law of Trusts* of ROC.

Thus, the Chinese *Law of Trusts* does not adopt both the standard of the duty of care adopted by the Second Draft of the Law and the standard of a good manager adopted by the *Law of Trusts* of Japan, South Korea, and Taiwan. Instead, it only uses the term “prudence” to describe the degree of a trustee’s duty of care. Compared with the duty of care in the Second Draft of the Chinese *Law of Trusts* and the duty of care of a good manager, it is suggested that the duty of care adopted by article 25 (2) of the Chinese *Law of Trusts* shall be interpreted as that a trustee shall, in good faith, manage and dispose of the trust property with such care as a prudent person would exercise in dealing with his/her own property. It means that it is not sufficient for a trustee administering the trust property merely with such care as he/she exercises in dealing with his/her own property. The trustee must act as a prudent person, rather than an ordinary person, would do. In Chinese, there is difference between a prudent person and an ordinary person. An ordinary person may be prudent, but he/she is not necessarily prudent. Thus, to distinguish a prudent person from an ordinary person is necessary in China. In addition, the trustee must act in good faith and with efficiency. Actually, the degree of the duty of care imposed on a trustee by article 25 (2) of the Chinese *Law of Trusts* is similar to that of the duty of care under the Common Law which was imposed on a trustee by Lindley LJ in *Re Whiteley*.<sup>52</sup>

The duty of care under the Civil Law comprises the following specific duties.

### ***The duty to keep the trust property and accounts separate***

Trust property is not the trustee’s own property, so the trustee shall keep the trust property and the accounts of the trust property separate.

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<sup>52</sup> . (1886) 33 Ch D 347 at 355.

Article 29 of the Chinese *Law of Trusts* provides:

A trustee shall administer the trust property and his/her own property separately and keep separate accounts of the properties. He/she shall also administer the trust properties under different trusts separately and keep separate accounts of these trust properties.

In Japan, South Korea and Taiwan, the duty to keep the trust property and accounts separate is divided into two duties which are provided for in different articles. For example, article 28 of the Japanese *Law of Trusts* provides:<sup>53</sup>

The trust property shall be managed set apart from the trustee's own property and other trust properties, provided however, that with regard to moneys that are trust property, it shall be sufficient to keep separate account of them.

Article 39 of the Japanese *Law of Trusts* provides:<sup>54</sup>

- (1) The trustee shall keep books and make clear as to each of the trusts the management of its affairs and accounts.
- (2) The trustee must, at the time of acceptance of trust and also regularly once a year, prepare the inventory as to each of the trusts.

The requirement that the trustee keeps the trust property and accounts separate serves the two purposes: to prevent the trustee from mixing the trust properties under different trusts to the prejudice of the beneficial interests of the different beneficiaries, and to ensure the trust property will not be reached by the creditors of the trustee.

Except that the method of administering money can be achieved by keeping separate accounts, the methods of administering other trust properties may vary according to the nature of the properties.

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<sup>53</sup> . See the South Korean *Law of Trusts*, article 30; the *Law of Trusts* of ROC, article 24.

<sup>54</sup> . See the South Korean *Law of Trusts*, article 33; the *Law of Trusts* of ROC article 31.

***The duty to keep a record of, and to report to the settlor and the beneficiary on, the conduct of trust affairs***

To ensure and explain that a trustee conducts the trust affairs for the optimal benefit of the beneficiary, the Chinese *Law of Trusts* imposes on the trustee the duty to keep a complete record in relation to the conduct of the trust affairs and the duty to report to the settlor and the beneficiary on the administration of the trust property.

Article 33 (1) and (2) of the Chinese *Law of Trusts* provides:

- (1) A trustee shall keep the complete record of conducting trust affairs.
- (2) The trustee shall report to the settlor and the beneficiary on the administration of the trust property and on the income and expenditure regularly each year.

Thus, apart from the duty to keep proper accounts of the trust property, a trustee is under a further duty to keep a complete record of the conduct of trust affairs. However, the duty to report on the administration of the trust property and on the income and expenditure to the settlor and the beneficiary seems redundant, because it is the right of a settlor and a beneficiary to examine the trustee's administration of the trust property and to examine the income and expenditure.<sup>55</sup>

Although the *Law of Trusts* of Japan, South Korea, and Taiwan do not require a trustee to keep a complete record of conducting the trust affairs, they provide that a trustee is under a duty to keep the books of both the accounts of the trust property and the conduct of the trust affairs.<sup>56</sup>

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<sup>55</sup> . The Chinese *Law of Trusts*, article 20 and article 49.

<sup>56</sup> . The Japanese *Law of Trusts*, article 39 (1); the South Korean *Law of Trusts*, article 33 (1); the *Law of Trusts* of ROC, article 31 (1).

### ***The duty to keep secret of the trust for the settlor and the beneficiary***

In certain cases, a settlor or a testator does not want other people know that he/she has created a trust for the benefit of himself/herself or for a certain person or certain persons. Accordingly, the Chinese *Law of Trusts* imposes a duty of secrecy on a trustee. Article 33 (3) of the Chinese *Law of Trusts* provides:

The trustee shall, in accordance with the law, assume the duty of confidentiality in relation to the settlor, the beneficiary, the trust affairs, and the trust documents.

The duty of secrecy is only provided for by the Chinese *Law of Trusts*. This duty is not singled out as a separate duty under the Common Law, because the duty not to disclose confidential information is one of the duties of a fiduciary.<sup>57</sup> Nor is it provided for by the *Law of Trusts* of Japan, South Korea, and Taiwan. The reason may be that the duty of care of a good manager itself includes the duty not to disclose confidential information.

Nevertheless, to provide for the duty to keep secret together with the duty to keep the complete record of the conduct of trust affairs and the duty to report to the settlor and the beneficiary in the same article of the Chinese *Law of Trusts* is appropriate and is of practical significance.

### ***The duty not to delegate***

Since a trustee is entrusted with the trust property on the basis of confidence, he/she is bound to administer the trust affairs personally and should not delegate it to any other persons. Article 30 (1) of the Chinese *Law of Trusts* provides:<sup>58</sup>

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<sup>57</sup> . See P D Finn: *Fiduciary Obligations* (1977), Ch. 19. “The Duty of Confidence”; J C Shepherd: *The Law of Fiduciaries* (1981), Ch. 23. “Confidential Information”.

<sup>58</sup> . See also the Japanese *Law of Trusts*, article 26 (1); the South Korean *Law of Trusts*, article 37 (1); the *Law of Trusts* of ROC, article 25.

A trustee shall conduct the trust affairs personally; however, he can delegate the trust affairs to another person if it is otherwise provided by the trust instrument or if there exist compelling causes.

It is thought that the term “compelling causes” here should mean the causes which cannot be controlled by a trustee. When the compelling causes arise, the trustee can do nothing except to delegate his/her duties and powers to another person. However, the term is uncertain. It can be interpreted either in a broad sense or a narrow sense. Under the Common Law, it is impossible for a trustee to delegate his/her duties and powers to another person when such a “compelling cause” occurs, because it is a rule that “a trustee cannot delegate his trust”,<sup>59</sup> unless the trustee’s delegation is authorized by the trust instrument or permitted by statute.<sup>60</sup> It is suggested that the Chinese *Law of Trusts* should state the “compelling causes” more specifically, such as that the trustee is out of the State or the trustee is temporarily incapable of administering the trust by reason of physical infirmity.

In addition, it is necessary to distinguish delegating trust affairs to a third person from appointing an agent to deal with the trust property. To delegate trust affairs to another person means to cause another person to conduct trust affairs in the trustee’s place, while to appoint an agent to deal with trust property means the trustee employs an agent to help him/her administer the trust property. The trustee’s duty not to delegate trust affairs to another person does not prohibit him/her from employing an agent.

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<sup>59</sup> . *In re Speight* (1883) 22 Ch D 727 at 757 (per Lindley LJ).

<sup>60</sup> . *Trusts Act* 1973 (Qld), s 56; *Trustee Act* 1962 (WA), s 54; *Trustee Act* 1958 (Vic), s 30; *Trustee Act* 1936 (SA), s 17; *Trustee Act* 1925 (NSW), s 64; *Trustee Act* 1898 (Tas), s 25AA.

### ***The duty to act jointly***

Where there are two or more trustees, the co-trustees shall administer trust affairs jointly. Article 31 (2) of the Chinese *Law of Trusts* provides:

Co-trustees shall conduct trust affairs jointly, except where it is otherwise provided by the trust instruments.

In addition, Article 24 of the Japanese *Law of Trusts* provides:<sup>61</sup>

- (1) Where there are several trustees, the trust property shall be held by them in joint tenancy.
- (2) In the case mentioned in the preceding paragraph, the administration of trust affairs shall be undertaken by the trustees jointly, except in cases where it is provided otherwise in the act of trust, provided however, that manifestation of intention made to any of them shall take effect against all the other trustees as well.

Where the co-trustees disagree with one another in respect of administering trust affairs, the *Law of Trusts* of Japan and South Korea do not provide a solution. However, article 31 (3) of the Chinese *Law of Trusts* gives a solution by providing:

Where the co-trustees disagree with one another in conducting the trust affairs, they shall conduct the trust affairs in accordance with the trust instruments; where there are no such provisions in the trust instrument, they shall conduct the trust affairs in accordance with the decisions made by the settlor, the beneficiary or the interested persons.

This provision is absolutely unsatisfactory. It is redundant to provide that “the co-trustees shall conduct the trust affairs in accordance with the trust instruments” when they have a dispute as to how to conduct trust affairs, because article 25 (1) of the *Law* already requires the trust affairs to be conducted for the optimal benefits of the beneficiaries in accordance with the trust instrument as the first and overarching duty of the trustees.

Also, to let the interested persons decide how the co-trustees act when they have disagreement is not reasonable. The co-trustees conduct trust affairs for the benefit of the

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<sup>61</sup> . See also the South Korean *Law of Trusts*, article 45; the *Law of Trusts* of ROC, article 28.

beneficiaries, not for anyone else, so it is wrong to allow the interested persons deciding the trustee's administration of trust affairs. Even worse, this provision does not clearly point out whether the interested persons refer to the co-trustees as interested persons or the beneficiaries as interested persons.

Again, to let the settlor decide how the trustees should conduct the trust affairs is also unsatisfactory. On the same basis that the trustees conduct trust affairs solely for the beneficial interests of the beneficiaries, the settlor should not decide how the co-trustees should do so unless the settlor reserves such right in the trust instrument.

In addition, article 31 (3) of the Chinese *Law of Trusts* does not provide what happens if there is a disagreement between the settlor, the beneficiary, and the interested persons.

With respect to this problem, the provisions of the *Law of Trusts* of ROC are worth adopting. Article 28 (3) of the *Law* provides:

Where the co-trustees disagree with one another in respect of the conduct of trust affairs, it shall obtain the consent of all the beneficiaries. Where there is disagreement between the beneficiaries, it shall be decided by the court on application.

However, it is a pity that this article does not specify who is entitled to apply the court to make a decision. It is suggested that in introducing this article into the Chinese *Law of Trusts*, there should be a provision under which either the co-trustees or the beneficiaries have the right to make the application to the court.

### **3.1.2 Liabilities of a Trustee**

To breach any of the duties of a trustee constitutes a breach of a trust. There are liabilities imposed on trustees who have acted in breach of trusts. A trustee is liable for his/her breach of a trust under both the Common Law and the Civil Law.

### **3.1.2.1 Liabilities of a trustee under the Common Law**

#### **3.1.2.1.1 The liabilities of a trustee**

Under the Common Law, liability is imposed on a trustee who acts in breach of a trust. The essential liabilities of the trustee are to restore the trust estates, to compensate and to make good any loss caused by the breach of the trust. In *Target Holdings Ltd v Redfems*,<sup>62</sup> Lord Browne-Wilkinson lucidly expounded:<sup>63</sup>

The equitable rules of compensation for breach of trust have been largely developed in relation to such traditional trusts, where the only way in which all the beneficiaries' rights can be protected is to restore to the trust fund what ought to be there. In such a case the basic rule is that a trustee in breach of trust must restore or pay to the trust estate either the assets which have been lost to the estate by reason of the breach or compensation for such loss. Courts of Equity did not award damages but, acting in personam, ordered the defaulting trustee to restore the trust estate: ... If specific restitution of the trust property is not possible, then the liability of the trustee is to pay sufficient compensation to the trust estate to put it back to what it would have been had breach not been committed: ... Even if the immediate cause of the loss is the dishonesty or failure of a third party, the trustee is liable to make good that loss to the trust estate if, but for the breach, such loss would not have occurred: ...

With respect to the liability of co-trustees, the general principle is that the co-trustees are liable to their beneficiaries for the breach of trust jointly and severally, since the co-trustees are joint owners of the trust property. That means that any one who is entitled to demand from the trustees for compensation for the loss caused by a breach of trust can make the demand of any or all of the trustees for compensation. Where one of the co-trustees makes good the loss, he/she is able to claim contribution from other co-trustees.

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<sup>62</sup> . [1996] 1 AC 421.

<sup>63</sup> . Ibid, 434.

However, the general principle has been changed by some statutes so that a co-trustee is liable only for his/her own breach of duty to the beneficiary and is not liable for the breach of trust committed by other co-trustees.

Section 224 (1) of the *Restatement of Trusts 2d* provides: “Except as stated in subsection (2), a trustee is not liable to the beneficiary for a breach of trust committed by a co-trustee”. Section 224 (2) of the *Restatement* has listed four circumstances under which the co-trustee violates his/her duties.

In addition, section 59 (2) of the *Trustee Act 1925* of New South Wales provides:<sup>64</sup>

A trustee shall be answerable and accountable only for the trustee’s own acts, receipts, neglects, or defaults, and not for those of any other trustee, nor for any banker, broker, or other person with whom any trust moneys or securities may be deposited, nor for the insufficiency or deficiency of any securities, nor for any other loss, unless the same happens through the trustee’s own wilful neglect or default.

As discussed above, the *Trusts Act 1973* (Qld) merely uses the term “default” and the *Trustee Act 1936* (SA) adopts different expressions different from the term “wilful neglect or default” of the New South Wales as well as the mere term “default” of Queensland.

### **3.1.2.1.2 The exemption of liabilities of a trustee**

Under certain circumstances, although a breach of trust occurs, the trustee is not liable for the breach of trust.

First, where a trustee is or may be personally liable for a breach of trust, he/she may be relieved from the liability wholly or partly by court. In Australia, all the States provide

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<sup>64</sup> . See also the *Trusts Act 1973* (Qld), s 71; *Trustees Act 1962* (WA), s 70; *Trustee Act 1958* (Vic), s 36; *Trustee Act 1936* (SA), s 35; *Trustee Act 1898* (Tas), s 27.

such relief to the trustees. For example, section 76 of the *Trustee Act 1973* (Qld) provides:<sup>65</sup>

If it appears to the court that a trustee, whether appointed by the court or otherwise, is, or may be, personally liable for any breach of trust, whether the transaction alleged to be a breach of trust occurred before or after the commencement of this Act, but has acted honestly and reasonably, and ought fairly to be excused for the breach of trust and for omitting to obtain the directions of the court in the matter in which the trustee committed the breach, then the court may relieve the trustee either wholly or partly from personal liability for that breach.

Thus, if a trustee wants to get relief from his/her personal liability by the court, he/she must meet the two requirements simultaneously: proving that he/she has acted honestly and reasonably, and showing that he/she has reasons to be fairly excused. It is not enough for a trustee to be protected by the section if he/she can only prove that he/she has acted honestly and reasonably.<sup>66</sup> In addition, it is a matter for discretion of the court regarding to whether or not relieving the trustee wholly or partly from his/her personal liability and “the court will not formulate a list of conditions under which relief will be granted”.<sup>67</sup>

Secondly, a trustee is not liable for a breach of trust if the beneficiary brings an action beyond the limitation period. Section 219 (1) of the *Restatement of Trusts 2d* provides:

The beneficiary cannot hold the trustee liable for a breach of trust if he fails to sue the trustee for the breach of trust for so long a time and under such circumstances that it would be inequitable to permit him to hold the trustee liable.

In the light of section 8 of the *Trustee Act 1888* (UK), in England, the limitation period of an action brought against a trustee is six years except in the following three circumstances: the claim is based on the fraud or fraudulent breach of trust to which the

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<sup>65</sup> . *Trustees Act 1962* (WA), s 75; *Trustee Act 1958* (Vic), s 67; *Trustee Act 1936* (SA), s 56; *Trusts Act 1973* (NSW), s 85; *Trustee Act 1898* (Tas), s 50.

<sup>66</sup> . *National Trustees Company of Australasia Limited v General Finance Company of Australasia Limited* [1905] AC 373.

<sup>67</sup> . Meagher and Gummow: *Jacobs' Law of Trusts* (1997, 6<sup>th</sup> ed), para 2214.

trustee was party or privy; the claim is to recover trust property or its proceeds still retained by the trustee; the claim is to recover trust property or its proceeds which has received by the trustee and converted to his/her own use.

This section was adopted by the limitation statutes of all the Australian states.<sup>68</sup> However, unlike the *Trustee Act* 1888 (UK) and its counterpart in other states which provide there is no limitation period in favour of the trustee under the above three circumstances, section 47 of the *Limitation Act* 1969 (NSW) provides that in above three situations, the limitation period is 12 years.

Thirdly, where a breach of trust is committed by the trustee at the instigation, request, or with the consent of the beneficiary, the trustee is not liable for the breach of trust. This principle was laid down as early as 1818 by Lord Eldon LC in *Walker v Symonds*.<sup>69</sup>

In Australia, all the states have statutory provisions to indemnify a trustee who commits a breach of trust at the instigation or request or with the consent in writing of a beneficiary. For example, section 77 (1) of the *Trusts Act* 1973 (Qld) relieves a trustee from liability by providing:<sup>70</sup>

Where a trustee commits a breach of trust at the instigation or request or with the consent in writing of a beneficiary, the court may, if it thinks fit, make such order as to the court seems just for impounding all or any part of the interest of the beneficiary in the trust estate by way of indemnity to the trustee or persons claiming through the trustee.

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<sup>68</sup> . *Limitation Actions Act* 1974 (Qld), s 27; *Limitation Act* 1974 (Tas), s 24; *Limitation Act* 1969 (NSW), ss 47 and 48; *Limitation of Actions Act* 1958 (Vic), s 21; *Limitation of Actions Act* 1946 (SA), s 31 and 32; *Limitation Act* 1935 (WA), s 47.

<sup>69</sup> . (1818) 3 Swans 1; 36 ER 751, at 64 and at 774 respectively.

<sup>70</sup> . *Trustees Act* 1962 (WA), s 76; *Trustee Act* 1958 (Vic), s 68; *Trustee Act* 1936 (SA), s 57; *Trusts Act* 1973 (NSW), s 86; *Trustee Act* 1898 (Tas), s 53.

### **3.1.2.2 Liabilities of a trustee under the Civil Law**

Under the Civil Law, where a trustee commits a breach of trust, he/she is liable for restoring the trust assets or compensating for the losses caused by the breach of trust.

Article 27 of the Japanese *Law of Trusts* provides:<sup>71</sup>

In cases where the trustee has inflicted losses upon the trust property through mismanagement, or disposed of the trust property in violation of the tenor and purpose of the trust, the settlor, his or her heir, the beneficiary, and other trustees may demand of the trustee indemnification of losses or restitution of the trust property.

Apart from providing generally that a trustee is liable for the losses caused by his/her violation of the trust purpose, by his/her breach of duties, or by his/her mismanagement, the Chinese *Law of Trusts* also specifically provides that the trustee shall be liable for the losses caused by his/her breach of the duty not to convert trust property into his/her own property and his/her breach of the duty not to transact with the trust property or to transact the trust properties under different trusts.<sup>72</sup>

In addition, the *Law of Trusts* of China and Taiwan provide that where a trustee makes profits in breach of his/her duties, the trustee shall convert the profits into the trust property. Article 26 (1) of the Chinese *Law of Trusts* provides that “except for obtaining the remuneration in accordance with the provisions of this Law, a trustee cannot make use of the trust property for his own profits”. If the trustee violates his/her duty, he/she is liable to disgorge the profits he/she has obtained and the profits will be part of the trust properties.<sup>73</sup>

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<sup>71</sup> . See also the Chinese *Law of Trusts*, article 22 (1); the South Korean *Law of Trusts*, article 38.

<sup>72</sup> . The Chinese *Law of Trusts*, article 27 and 28.

<sup>73</sup> . Ibid, article 26 (2).

In Taiwan, where a trustee makes profits in violation of the duty to keep the trust property separate<sup>74</sup> or in violation of the duty neither to make the trust property his/her own property nor to acquire any right thereon,<sup>75</sup> the settlor, the beneficiary or any of other co-trustee may demand the trustee to surrender the profits, which he/she has obtained by violating these duties, and to convert the profit into the trust property.<sup>76</sup> If the trustee acts in bad faith to make profits in violation not to make the trust property his/her own property and not to acquire any right thereon, he/she is liable to convert both the corpus and the interests of the profits into the trust property.<sup>77</sup>

However, with respect to the liability, the positions in China and Taiwan are different. In China, the trustee who has obtained such profits is liable to convert the profits into the trust property unconditionally and automatically in that the trustee administers the trust property solely for the benefit of the beneficiary; whereas in Taiwan, the liability of the trustee is conditional. It is a right of claim of the settlor, the beneficiary or other co-trustee and such right of claim will expire by reason of beyond the limitation period. Both article 24 (4) and article 35 (4) of the *Law of Trusts* of ROC exactly provide:

The limitation period of the right of claim provided for by the preceding Paragraph<sup>78</sup> expires within two years from the date on the settlor or the beneficiary becomes aware that the profits have been obtained by the trustee. It will also expire five years after the fact of the profits having been obtained had occurred.

It is noteworthy that there is a drafting defect in article 35 (4) of the *Law of Trusts* of ROC. Although article 35 (3) of the *Law* provides that another co-trustee has the right to

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<sup>74</sup> . The *Law of Trusts* of ROC, article 24 (3)

<sup>75</sup> . Ibid, article 35 (3).

<sup>76</sup> . Article 24 (3) of the *Law of Trusts* of ROC only provides that the settlor or the beneficiary has the right to claim, while article 35 (3) of the *Law* provides that the settlor, the beneficiary or any other co-trustee has such right of claim.

<sup>77</sup> . The *Law of Trusts* of ROC, article 35 (3).

<sup>78</sup> . The *Law of Trusts* of ROC, article 24 (3) and article 35 (3).

demand the defaulting trustee to convert the profits, which he/she has obtained in violation of the duty not to make the trust property his/her own property and the duty not to acquire any right thereon, into the trust property, article 35 (4), following article 24 (4), negligently omitted the right of claim of such co-trustees. In addition, it is unreasonable to apply such two kinds of limitation periods to a trust, especially where the trust will exist longer than five years.

Moreover, in Taiwan, a trustee is liable for being paid reduced remuneration or paid no remuneration. Article 23 of the *Law of Trusts* of ROC provides:

Where the trustee has inflicted losses upon the trust property through mismanagement, or disposed of the trust property in violation of the trust purpose, the settlor, the beneficiary or any other co-trustees may demand of the trustee for indemnification of the losses or restitution of the trust property and may demand to reduce the remuneration payable to the trustee or pay no remuneration to the trustee.

Regarding the reduction of the remuneration or the refusal to pay the remuneration as a method of setting off the losses caused by trustee's breach of trust is practicable, but it is inappropriate to regard it as a liability. In fact, this problem is already solved by other provisions of the *Law of Trusts* of ROC. For example, article 44 of the *Law* provides:<sup>79</sup>

The rights of a trustee provided for by the preceding five articles cannot be exercised before the trustee has discharged the duties of restitution of the trust property, indemnification of losses or converting profits into the trust property which are prescribed by Article 23 or Article 24 (3).

Therefore, it is better to provide that a defaulting trustee cannot claim his/her rights including the demand of remuneration unless he/she has discharged his/her liabilities and it is neither necessary nor appropriate to provide the reduction of remuneration or refusal to pay remuneration as a kind of liabilities of the trustee.

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<sup>79</sup> . See also the Japanese *Law of Trusts*, article 38; the South Korean *Law of Trusts*, article 44.

Compared with the *Law of Trusts* of ROC, the provisions of the Chinese *Law of Trusts* concerning the remuneration of a defaulting trustee are more reasonable. For example, article 36 of the Chinese *Law of Trusts* provides:

Where a trustee has caused losses to the trust property by disposing of trust property in violation of trust purpose, in violation of trustee's duties and powers, or by mismanaging trust affairs, he/she cannot demand of the payment of remuneration before he/she has restored the trust property or indemnified the losses of the trust assets.

In respect of the liabilities of co-trustees, they are joint and several no matter whether the co-trustees are liable to the beneficiaries or to other third persons in that the co-trustees are joint owners of the trust property.

Article 32 of the Chinese *Law of Trusts* provides:

- (1) The co-trustees shall assume the joint and several liabilities for the debts owned to a third party by virtue of administering the trust affairs. The declaration of intention of the third party made to one of the co-trustees is effective as against all the other co-trustees.
- (2) Where one of the co-trustees has inflicted losses upon the trust property by disposing of the trust property in violation of the trust purpose, in breach of his/her duties and powers or by mismanaging trust affairs, all the co-trustees shall be assume the joint and several liabilities.

Article 25 of the Japanese *Law of Trusts* also provides for the liabilities of co-trustees, which reads:<sup>80</sup>

Where there are several trustees, obligations owed to the beneficiary by virtue of the act of trust shall be joint and several. The same shall also apply to obligations owed in connection with the management of trust affairs.

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<sup>80</sup>. Article 46 of the South Korean *Law of Trusts* and article 29 of the *Law of Trusts* of ROC re-enacted article 25 of the Japanese *Law of Trusts*.

### 3.1.3 Powers of a Trustee

Powers are the basis on which a trustee administers trust business. A power of a trustee means a possibility which the trustee may do or may not do an act as he/she thinks fit. In a sense, a power is a kind of right which he/she may exercise or not.

The distinction between a power and a duty is that whereas a duty requires a trustee to do or not to do an act, a power merely gives the trustee an option which he/she can elect to exercise or not. A court does not compel a trustee to exercise a power if he/she honestly decides not to exercise it, but the court will compel the trustee to perform his/her duty. However, a trustee's duty is closely related to his/her power.

Since a trustee can elect whether or not to exercise a power, such election made by the trustee is based on his/her discretion. However, although a trustee has the discretion, he/she must exercise such discretion honestly to decide whether he/she should or should not exercise the power. In this sense, the trustee is under the duty to exercise his/her discretion. In addition, a power and a duty may be connected with each other. For example, a trustee is under the duty not to delegate the trust to others, while there is a power to delegate in certain circumstances. Again, to insure the trust property is a power of a trustee, so he/she may choose to insure or not to insure the trust property. However, to insure the trust property is also a duty,<sup>81</sup> or a duty only in certain cases.<sup>82</sup>

Under the Common Law, the powers of a trustee are specific and clear, while under the Civil Law, the powers of a trustee are specified in an abstract way and it is always confused with the rights of a trustee.

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<sup>81</sup> . See illustration 3 to section 176 of the *Restatement of Trusts 2d*.

<sup>82</sup> . *Pateman v Heyen* (1993) 33 NSWLR 188.

### **3.1.3.1 Powers of a trustee under the Common Law**

Under the Common Law, powers may be conferred on a trustee by the trust instrument, statute or by the court. Nonetheless, because only a few states adopted the *Uniform Trustees' Powers Act*,<sup>83</sup> the powers conferred by statute in America are not as common as those in England and Australia. In America, section 186 of the *Restatement of Trust 2d* divides the powers of a trustee into express powers, which “are conferred on the trustee in specific words by the terms of trust”, and implied powers, which “are necessary or appropriate to carry out the purposes of the trust and are not forbidden by the terms of the trust”.

According to sections 188 to 193 of the *Restatement*, a trustee possesses mainly the following powers: the power to incur expenses; the power to lease; the power to sale; the power to mortgage or pledge or borrow money; the power to compromise, arbitrate and abandon claims; the powers with respect to shares of stock.

Usually, the trust instrument would confer on a trustee certain powers. However, the powers conferred by the trust instrument may be too narrow, or broad, or too abstract and unclear. Therefore, in England and Australia, the statutes directly confer on trustees powers so that the trustees can administer trust business efficiently.

In England, the English *Trustee Act 1925* confers on a trustee many statutory powers, which are mainly as follows: the power to invest (section 2, 5 and 6); the power to deposit money at bank and to pay calls (section 11); the power to sell by public auction or by private contract (section 12) and to sell subject to depreciatory conditions (section 13); the power to insure (section 19); the power to employ agents (section 23); the power to delegate trust (section 25); the power to apply income for maintenance and to accumulate

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<sup>83</sup> . Scott and Fratcher: *The Law of Trusts* (1988, 4<sup>th</sup> ed), §186.

surplus income during a minority (section 31); and the power of advancement (section 32). However, section 69 (2) of the *Trustee Act 1925* provides:

The powers conferred by this Act on trustees are in addition to the powers conferred by the instrument, if any, creating the trust, but those powers, unless otherwise stated, apply if and so far only as a contrary intention is not expressed in the instrument, if any, creating the trust, and have effect subject to the terms of that instrument.

In addition to the powers conferred on trustees by the *Trustee Act 1925*, the *Trustee Act 2000* (UK) has modified some of the powers conferred by the former Act and conferred more powers on trustees. The *Trustee Act 2000* mainly provides for the following powers of trustees: the general power of investment which “a trustee may make any kind of investment that he could make if he were absolutely entitled to the assets of the trust”;<sup>84</sup> the power to acquire freehold and leasehold land (section 8); the power to appoint nominees (section 16); the power to appoint custodians (section 17); the power to insure which has modified section 19 of the *Trustee Act 1925* as “to insure any property which is subject to the trust against risks of loss or damage due to any event and pay the premiums out of the trust funds”<sup>85</sup>.

In Australia, all the states have their Trustee or Trusts Acts <sup>86</sup> which confer on trustees a wide range of powers. It is noteworthy that there is a fundamental distinction between Queensland and other States in respect of the application of the statutory powers. In the States other than Queensland, the statutes, following the English *Trustee Act 1925*, provide that the statutory powers conferred on trustees can apply if and so far only as a contrary intention is not expressed in the trust instrument. The statutes of Western

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<sup>84</sup> . The *Trustee Act 2000* (England), s 3 (1).

<sup>85</sup> . *Ibid*, s 34 (1).

<sup>86</sup> . The trustee or trusts acts are: *Trusts Act 1973* (Qld), *Trustees Act 1962* (WA), *Trustee Act 1958* (Vic), *Trustee Act 1936* (SA), *Trustee Act 1925* (NSW), and *Trustee Act 1898* (Tas).

Australia, Victoria and Tasmania each have a general provision to provide the application of the statutory powers. For example, section 5 (2) of the *Trustee Act 1962* (WA) provides:<sup>87</sup>

The powers conferred by or under this Act on a trustee who is not a corporation are in addition to the powers given by any other Act and by the instrument (if any) creating the trust; but the powers conferred on the trustee by this Act, unless otherwise stated, apply if and so far only as a contrary intention is not expressed in the instrument (if any) creating the trust, and have effect subject to the terms of that instrument.

New South Wales and South Australia do not adopt a general provision stipulating the application of the statutory powers, but it can be inferred from other provisions that the statutory powers cannot prevail over the powers conferred by the trust instruments. For example, the title of section 40 of the *Trustee Act 1925* (NSW) is the provision on powers and subsection 6 of this section provides:

(6) This section applies only if and as far as a contrary intention is not expressed in the instrument, if any, creating the trust, and shall have effect subject to the terms of that instrument and to the provisions therein contained.

On the contrary, in Queensland, the *Trusts Act 1973* (Qld) provides that the statutory powers, except the power to invest, conferred on trustees prevail over the powers conferred by the trust instrument. For example, section 31 (1) of the *Trusts Act 1973* (Qld) provides:

Except where otherwise provided in this part, the provisions of this part shall apply whether or not a contrary intention is expressed in the instrument (if any) creating the trust.

With respect to the power to invest, section 21 of the *Act* provides:

A trustee may, unless expressly forbidden by the instrument creating the trust—

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<sup>87</sup> . See also *Trustee Act 1962* (WA), s 5 (3); *Trustee Act 1958* (Vic), s 2 (3); *Trustee Act 1898* (Tas), s 64 (2).

- (a) invest trust funds in any form of investment; and
- (b) at any time, vary an investment or realise an investment of trust funds and reinvest an amount resulting from the realisation in any form of investment.

Taking examples from the *Trusts Act 1973 (Qld)*,<sup>88</sup> in Australia, the trustees have more than twenty specific powers, such as the power to invest, the power to sell, exchange, partition, postpone, lease etc, the power of trustee to sell by auction and to sell subject to depreciatory conditions, and the power to renew leases.

### **3.1.3.2 Powers of a trustee under the Civil Law**

The specific powers of trustees are fundamental to the administration of trusts under the Common law. However, the trusts law in the Civil Law jurisdictions does not confer specific powers on trustees, although that law empowers trustees to delegate the administration of the trusts.<sup>89</sup> Instead, the trusts law confers only a general and abstract power on trustees. That is the trustees shall administer trust affairs without breaching their duties.

Traditionally, the rights, duties and liabilities of parties to civil juristic acts are three themes of civil law. The rights of one party are usually the duties of the other. Any party who breaches his/her duty to a juristic act will assume the corresponding liabilities. Generally, a party to a juristic act can do whatsoever he/she likes to do in respect of performing his/her duties so long as he/she does not breach such duties. Under certain circumstances, a party to a civil juristic act may have certain powers conferred on him. For example, in respect of an agency, the agent may have powers conferred on him by the

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<sup>88</sup> . See relevant sections of Part 3 – Investments, Part 4 – General Powers of Trustees, and other relevant sections in other parts of the *Trusts Act 1973 (Qld)*.

<sup>89</sup> . The Chinese *Law of Trusts*, article 30 (1); the Japanese *Law of Trusts*, article 26 (1); the South Korean *Law of Trusts*, article 37 (1); the *Law of Trusts* of ROC, article 25.

principal, including written or oral authorizations to undertake the agency. However, the laws do not confer specific powers on parties to civil juristic acts. The powers and authorizations of the parties are usually prescribed by the parties themselves. Thus, with no exception, the *Law of Trusts* of these Civil Law jurisdictions only provide for the rights, duties and liabilities of trustees.

Although the term “right” and the term “power” are written differently as “权利” and “权力” respectively, in Chinese, they are pronounced almost the same as “*quanli*” (the accent on “li” is different in respect of these two words) and they are often confused. For example, when a scholar was introducing the powers conferred on trustees by the English *Trustee Act 1925*, he misconstrued the powers as rights.<sup>90</sup> In China, powers are also called “*zhiquan*”(职权). “*Zhi*” means a kind of office. Thus “*zhiquan*” refers to a power or privilege controlled by a person holding a certain position, or briefly, means a power of an office. It is clear that there is distinction between a right and a power. A right means a privilege which a person can, for his/her own behalf, do or ask another person to do or not to do a given act, while a power means a privilege which a person has obtained by virtue of a certain position he/she occupies and with which the person has the liberty or authorization to do or not to do a given act for the benefit of others and, or for, himself.

At present, it seems that it is not wrong for the current Chinese *Law of Trusts* to confer on a trustee the general power of administering trust affairs within the ambit of the trust instrument. However, with the development of the trust business in China, it is suggested that the Chinese *Law of Trusts* should intervene to confer on trustees a wide range of powers so as to “avoid the situations of trustees being ill-equipped by the trust

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<sup>90</sup> . Zhang Chun: *The Basic Law of Trusts* (1994), p 141.

instrument”.<sup>91</sup> Nonetheless, should the Chinese *Law of Trusts* confer on trustees powers, it should not follow the model of Queensland, Australia. It should accept the principle adopted by the states of Western Australia, Victoria and Tasmania, namely the principle that the powers conferred by law can only apply if or so far only as a contrary intention is not expressed in the trust instruments creating the trust.

### **3.1.4 Rights of a Trustee**

#### ***3.1.4.1 Rights of a trustee under the Common Law***

Apart from performing duties, assuming liabilities, exercising powers, a trustee also enjoys certain rights. Usually, a trustee is entitled to be indemnified for his/her expenses incurred in the course of conducting trust affairs, is entitled to the remuneration if he/she is not a gratuitous trustee, and is entitled to demand other co-trustees of contribution after he/she has made good the losses.

##### **3.1.4.1.1 The right of indemnity**

In *Worrall v Harford*,<sup>92</sup> Lord Eldon stated:<sup>93</sup>

It is in the nature of the office of a trustee, whether expressed in the instrument or not, that the trust property shall reimburse him all the charges and expenses incurred in the execution of the trust. That is implied in every trust.

Thus, where a trustee has incurred expenses or losses in the execution of the trust, he/she has the right to indemnify himself/herself from the trust assets. It is the general

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<sup>91</sup> . Denis Ong: *Trusts Law in Australia* (2003, 2<sup>nd</sup> ed), p 252.

<sup>92</sup> . (1802) 8 Ves 4; 32 ER 250.

<sup>93</sup> . Ibid, at 8, and 252 respectively.

law and has been confirmed by section 30 (2) of the English *Trustee Act 1925*, which provides:

A trustee may reimburse himself or pay or discharge out of the trust premises all expenses incurred in or about the execution of the trusts or powers.

However, only the expenses reasonably or properly incurred by a trustee can be reimbursed. Section 31 (1) of the *Trustee Act 2000* (UK) has modified section 30 (2) of the *Trustee Act 1925* (UK) as following:

A trustee-

- (a) is entitled to be reimbursed from the trust funds, or
- (b) may pay out of the trust funds, expenses properly incurred by him when acting on behalf of the trust.

In Australia, all the States confer on a trustee such right of indemnity,<sup>94</sup> like the English *Trustee Act 1925* does. The typical provision is section 72 of the *Trusts Act 1973* (Qld) which reads:

A trustee may reimburse himself or herself for or pay or discharge out of the trust property all expenses reasonably incurred in or about the execution of the trusts or powers.

### ***The nature of the right of indemnity***

The nature of the trustee's right to indemnify is essentially an equitable charge imposed upon the trust property prior to the beneficiaries and, furthermore, is the property of the trustee or the proprietary interests of the trustee in the trust property. In *Chief Commissioner of Stamp Duties v Buckle*,<sup>95</sup> the High Court held:<sup>96</sup>

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<sup>94</sup> . *Trusts Act 1973* (Qld), s 72; *Trustees Act 1962* (WA), s 71; *Trustee Act 1958* (Vic), s 36 (2); *Trustee Act 1936* (SA), s 35 (2); *Trustee Act 1925* (NSW), s 59 (4); and *Trustee Act 1898* (Tas), s 27 (2).

<sup>95</sup> . (1998)151 ALR 1.

<sup>96</sup> . *Ibid*, at 14 (per Brennan CJ, Toohey, Gaudron, McHugh and Gummow JJ who delivered a joint judgement).

The right of the trustee has been described as a first charge upon the assets vested in the trustee, as one upon the “trust assets, and as conferring upon the trustee an “interest in trust property [which] amounts to a proprietary interest”.

In *Octavo Investment Proprietary Limited v Knight*,<sup>97</sup> the High Court also held:<sup>98</sup>

In such a case there are then two classes of persons having a beneficial interest in the trust assets: first, the cestuis que trust, those for whose benefit the business was being carried on; and secondly, the trustee in respect of his right to be indemnified out of the trust assets against personal liabilities incurred in the performance of the trust. The latter interest will be preferred to the former, so that the cestuis que trust are not entitled to call for a distribution of trust assets which are subject to a charge in favour of the trustee until the charge has been satisfied ...

Again, it was held that “the trustee’s interest in the trust property amounts to a proprietary interest”.<sup>99</sup>

However, although the right of indemnity is an equitable charge over the trust assets, “the enforcement of the charge is an exercise of the prior rights conferred upon the trustee as a necessary incident of the office of trustee” and “it is not a security interest or right which has been created, whether consensually or by operation of law, over the interests of the beneficiaries so as to encumber them”.<sup>100</sup>

It was said that the right to indemnify comprises two rights: the right of reimbursement, which arises when a trustee has actually incurred expenses reasonably in the execution of trust; the right of exoneration, which arises when the trustee has only

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<sup>97</sup> . (1979) 144 CLR 360.

<sup>98</sup> . Ibid, at 367 (per Stephen, Mason, Aickin and Wilson JJ who delivered a joint judgement).

<sup>99</sup> . Ibid, at 370.

<sup>100</sup> . *The Chief Commissioner of Stamp Duties v Buckle* (1998) 151 ALR 1 at 14 (per Brennan CJ, Toohey, Gaudron, McHugh and Gummow JJ who delivered a joint judgement).

reasonably incurred a liability which he/she has not discharged. In *Re Blundell*,<sup>101</sup> Stirling J drew a clear distinction between the two kinds of rights, saying:<sup>102</sup>

What is the right of indemnity? I apprehend that in equity, at all events, it is not a right of the trustee to be indemnified only after he has made the necessary payments to his solicitors, or to the auctioneer, or to the stockholder – but that he is entitled to be indemnified, not merely against the payments actually made, but against his liability.

The nature of the reimbursement and the exoneration are different. In the case of the right of reimbursement, the trustee is just recouping what he/she has paid out for the beneficiaries; while in the case of the right of exoneration, the trustee suffers no losses but assumes the liability to pay debts of the trust creditors. When the trustee claims his/her right of reimbursement, he/she is claiming the right for his/her own interests. Thus, only the right of reimbursement of the trustee can be said the trustee's proprietary interest in the trust property. On the contrary, when the trustee exercises the right of exoneration, the purpose of the exercising of the right of exoneration is not for his/her own benefit, but for discharging the liabilities incurred by him/her in the execution of trust so as to benefit the creditors of trading trust.

### ***The creditor's right of subrogation***

In addition to holding that “the trustee's interest in trust property amounts to a proprietary interest”, more importantly, in *Octavo Investments Proprietary Limited v Knight*,<sup>103</sup> the High Court set out the right of subrogation of the trustee's creditors, saying:<sup>104</sup>

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<sup>101</sup> . (1888) 40 Ch D 370.

<sup>102</sup> . Ibid, at 376 – 377.

<sup>103</sup> . (1979) 144 CLR 360.

<sup>104</sup> . Ibid, at 370.

The trustee's interest in the trust property amounts to a proprietary interest, and is sufficient to render the bald description of the property as "trust property" inadequate. It is no longer property held solely in the interests of the beneficiaries of the trust and the trustee's interest in that property will pass to the trustee in bankruptcy for the benefit of the creditors of the trust trading operation should the trustee become bankrupt.

The fact that the trust property itself cannot be taken in execution by the creditors of the trustee is not to the point. Those creditors are nevertheless subrogated to the rights of the trustee in relation to that property, and in the event of the trustee becoming bankrupt, it is those rights which are to be realized in their favour.

Thus, where there are liabilities incurred by the trustee in the execution of the trust, the trustee's right of indemnity can be subrogated to by the trustee's creditors of trading trust, namely the trust creditors.

However, two points are worth noting. One is that only the right of exoneration rather than the right of reimbursement of a trustee can be subrogated to by the trust creditors of the bankrupt trustee. Ong states, "it is logically impossible for the trust creditors to be subrogated to the trustee's right of *reimbursement*, because the trustee's right of *reimbursement* arises only when the trustee has paid the relevant debts *with his own money*, and there cannot be subrogation to facilitate the payment of debts which have *already been paid*".<sup>105</sup>

The other is that the right of subrogation can only be exercised by the trust creditors of the bankrupt trustee. In *Re Byrne Australia Pty Ltd*,<sup>106</sup> Needham J clearly held: "I am of opinion that the assets of the company should be utilized in the payment of those creditors who can properly be called trust creditors".<sup>107</sup> Likewise, in *re Suco Gold Pty*

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<sup>105</sup> . Denis Ong: *Trusts Law in Australia* (2003, 2<sup>nd</sup> ed), p 304 (emphasis added by Ong).

<sup>106</sup> . [1981] 1 NSWLR 394.

<sup>107</sup> . *Ibid*, at 399.

*Ltd*,<sup>108</sup> the Full Court of South Australia insisted that the right of exoneration enjoyed by the trustee cannot be subrogated to by the non-trust creditors. In that case, King CJ said:<sup>109</sup>

I cannot escape the conviction that if a trustee, or his trustee in bankruptcy, or liquidator in the case of a trustee company, is permitted to use trust property, not for the discharge exclusively of liabilities incurred in the performance of the trust, but in the discharge of other liabilities as well, the money is being used for an unauthorised purpose and is being used, moreover, for the benefit of the trustee, and of third parties, namely, the non-trust creditors.

In respect of the reason why the right of exoneration of a bankrupt trustee can only be subrogated to by trust creditors of the trustee, according to Ong,<sup>110</sup> the right of exoneration cannot constitute the trustee's "own absolute property" and it "can be used *only* for the purpose of *exonerating* him from his *trust liabilities*".

### ***The right of indemnity against the beneficiaries personally***

It is quite possible that the trust assets may not be sufficient to reimburse the trustee. In this case, the trustee may claim the right of indemnity against the beneficiary or beneficiaries personally. However, not every beneficiary can be claimed against by the trustee, rather, only those beneficiaries who are sui juris, namely who are under no legal capacity can be claimed against.

In *Hardoon v Belilios*,<sup>111</sup> Lord Lindley lucidly expounded the principle, saying:<sup>112</sup>

But where the only cestui que trust is a person sui juris, the right of the trustee to indemnity by him against liabilities incurred by the trustee by his retention of the trust property has never been limited to the trust property; it extends further, and imposes upon the cestui que trust a personal

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<sup>108</sup> . (1983) 33 SASR 99. See also *Re ADM Franchise Pty Ltd* (1983) 7 ACLR 987.

<sup>109</sup> . *Ibid*, at 105.

<sup>110</sup> . Denis Ong: *Trusts Law in Australia* (2003, 2<sup>nd</sup> ed), p 304 (emphasis added by Ong).

<sup>111</sup> . [1901] AC 118.

<sup>112</sup> . *Ibid*, at 124.

obligation enforceable in equity to indemnify his trustee. This is no new principle, but is as old as trusts themselves.

In certain circumstances, the trustee's right of indemnity against the beneficiary personally may be excluded by the terms of the trust or by contract. Where a beneficiary has not enjoyed the beneficial interests, he/she will not be under the personal obligation to indemnify the trustee, such as a beneficiary who has disclaimed his beneficial interest or a beneficiary of a discretionary trust.

Although a trustee is of the right to indemnify against the beneficiary, the right shall be exercised only if the assets of the trust are not sufficient to indemnify the trustee.

### **3.1.4.1.2 The right to be paid remuneration**

Although to act gratuitously was regarded as a duty of trustee because of the old equity rule that trustees must not profit from their trust and are not entitled to remuneration,<sup>113</sup> the trustees are not prohibited from obtaining remuneration in certain situations. With the development of business trusts, more and more trustees are paid remuneration for their professional skill of administering trust affairs. Usually, a trustee may receive remuneration in the following situations. First, the trust instrument may expressly or impliedly prescribe that the trustee can receive remuneration.<sup>114</sup> Secondly, the trustee may enter into a special enforceable agreement with the beneficiary who will pay the trustee the remuneration.<sup>115</sup> Thirdly, the court may expressly allow the trustee to be paid remuneration. In Australia, all the States authorise the court to allow the trustee to

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<sup>113</sup> . *Robinson v Pett* (1734) 3 P Wms 249, 24 ER 1049; *Barrett v Hartley* (1866) LR 2 Eq 789; *Williams v Barton* [1927] 2 Ch 9.

<sup>114</sup> . *Re Bignell* [1892] 1 Ch 59; *In re Fish* [1893] 2 Ch 413; *Clarkson v Robinson* [1900] 2 Ch 722.

<sup>115</sup> . *Re Will of Moore* (1896) 17 LR (NSW) B 78.

be paid remuneration. For example, section 101 (1) of the *Trusts Act 1973* (Qld) provides:<sup>116</sup>

The court may, in any case in which the circumstances appear to it so to justify, authorise any person to charge such remuneration for the person's services as trustee as the court may think fit.

Although section 42 of the *Trustee Act 1925* (UK) only provides that the court has the power to authorise a corporation trustee to charge remuneration, the new *Trustee Act 2000* (UK) adopts one part, Part V, and six sections (section 28 to section 33) to provide for the remuneration of trustees. The legislative change in respect of the remuneration of trustees between the two English *Trustee Acts* reflects the advanced development of trust business.

### **3.1.4.1.3 The right of contribution from co-trustees**

In the above context relating to the liabilities of trustees, it is said that the co-trustees bear the liability to the beneficiaries jointly and severally and that where one of the co-trustees has made good to the losses caused by a breach of trust, he/she can claim contribution from the other co-trustees on his/her part. Thus, to claim the contribution from the other co-trustees is also one of the trustee's rights.

The general rule of the right of contribution was established in *Chillingworth v Chambers*,<sup>117</sup> where Smith LJ enunciated:<sup>118</sup>

[A]s between two trustees who are in pari delicto, the one who has made good a loss occasioned by a breach of trust for which the two are jointly and severally liable may obtain contribution to that loss from the other.

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<sup>116</sup> . See also *Trustees Act 1962* (WA), s 98; *Trustee Act 1898* (Tas), s 58; *Administration and Probate Act 1958* (Vic), s 65; *Administration and Probate Act 1919* (SA), s 70 (1); *Wills, Probate and Administration Act 1898* (NSW), s 86

<sup>117</sup> . [1896] 1 Ch 685.

<sup>118</sup> . *Ibid.*, at 707.

Usually, a trustee can only claim the right of contribution against the other co-trustees on a *pari passu* basis. However, if the breach of trust is caused by the fraudulent act of the other co-trustees and the innocent trustee has made good the losses, the innocent trustee is entitled to claim the other co-trustees an indemnity for the whole losses he/she has made good.<sup>119</sup> It was said that the right of contribution for the whole losses is a right of recoupment.<sup>120</sup> Actually, the choice of wording “the right of contribution” or “right of recoupment” expresses the same meaning, namely the trustee who has made good the loss is entitled to be reimbursed from the other co-trustees.

### **3.1.4.2 Rights of a trustee under the Civil Law**

The rights of a trustee under the Civil Law are essentially as same as those under the Common Law and mainly comprise the following rights: the right of indemnity, the right of remuneration and the right of contribution.

#### **3.1.4.2.1 The right of indemnity**

The trustee’s right of indemnity prescribed by the Chinese *Law of Trusts* is slightly different from that prescribed by the *Law of Trusts* of Japan, South Korea and Taiwan. The Chinese *Law of Trusts* empowers a trustee to use trust property to pay the expenses and debts incurred in the course of conducting trust affairs and confers on the trustee the right to reimburse him out of the trust assets prior to other general creditors if the trustee has paid such expenses and debts out of his/her own pocket. Essentially, to pay expenses and debts incurred in the administration of trust affairs out of the trust property is essentially a power of trustee. However, the *Law of Trusts* of Japan, South Korea and

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<sup>119</sup> . *Bahin v Hughes* (1886) 31 Ch D 390 at 395 – 396 (per Cotton LJ).

<sup>120</sup> . Meagher and Gummow: *Jacobs’ Law of Trusts* (1997, 6<sup>th</sup> ed), para 2118.

Taiwan provide that a trustee has the right either to sell the trust property to pay the expenses and debts or to reimburse him/her if he/she has suffered losses without negligence in conducting trust affairs, and that the trustee can claim such right in preference to other claimants. Thus, either to pay the expenses and debts or to compensate for his/her losses is the trustee's right.

Article 37 of the Chinese *Law of Trusts* provides:

- (1) The expenses and debts caused by the trustee in the course of conducting trust affairs shall be paid out of the trust property. Where the trustee has paid the expenses and debts out of his/her own property, he/she is entitled to reimburse him/her out of the trust property prior to other general creditors.
- (2) Where the debts and losses, which the trustee suffered, are caused by the trustee's mismanagement or by the trustee's violation of duties, the trustee shall be liable for the debts and losses him/herself.

It should carefully notice that there is a fatal printing mistake in this article which has not been corrected so far. The first sentence of article 37 (1) should mean that "the expenses and debts caused by the trustee in the course of conducting trust affairs shall be paid out of the trust property", but in respect of the expenses, it was printed incorrectly as "the expenses the trustee has paid" in Chinese. The meaning of that "the expenses a trustee shall pay" is quite different from the meaning of that "the expenses a trustee has paid". Unfortunately, the former was printed incorrectly and has not been corrected or even noticed so far.

In addition, article 37 (2) of the *Law* does not provide whether or not the trustee shall be liable for the expenses caused by his/her mismanagement or violation of duties. On the one hand, the expenses incurred by the trustee in the course of administering trust affairs are complicated which may be tax, public dues, or registration fees; on the other hand, the

degree and effect of the trustee's mismanagement or violation of duties may be greatly different. Perhaps, the legislative purpose of this article is to leave the problem to be solved by future legal interpretations or amendments.

Moreover, the Chinese *Law of Trusts* does not provide for the trustee's right of indemnity against the beneficiary personally if the trust property is insufficient to indemnify him/her. However, according to the general principle under the civil law that a right corresponds with a duty, since the beneficiary enjoys the right to the beneficial interests, he/she shall also bear the burden correlative to the beneficiary. Under the Common Law, the reason that the trustee's right of indemnity can be claimed against the beneficiary personally is that "absolute beneficial owners of property must in equity bear the burdens incidental to its ownership and not throw such burdens on their trustees".<sup>121</sup>

Thus, it is suggested that the Chinese *Law of Trusts* should follow the lead of the trusts law under the Common Law, and recognize that the trustee is entitled to claim the right of indemnity against the beneficiaries personally who are under no legal capacity and absolutely entitled to the trust property, except that it is otherwise provided for by the trust instrument. However, two points should be noted in providing the right of indemnity: one is that such right can only be exercised where the trust assets are insufficient to indemnify the trustee; the other is that the beneficiary is only liable for indemnifying the trustee to the extent of the beneficial interest. If the beneficiary has not enjoyed the beneficial interest, such as he/she has disclaimed his/her beneficial interest, the beneficiary should not be liable for indemnifying the trustee because the beneficiary should not bear unlimited personal liability.

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<sup>121</sup> . *Hardoon v Belilios* [1901] AC 118, at 124 (per Lord Lindley).

Apart from article 37 of the Chinese *Law of Trusts*, article 57 of the *Law* also provides that “where a trust is terminated, the trustee may detain the trust property to satisfy his right of indemnify or demand that the person, who is vested with the trust property because of the termination, reimburse him/her”. This article, in fact, confers the trustee the right of lien. However, the trustee cannot exercise such lien unless the trust is terminated and he/she has not been reimbursed.

In respect of the right of indemnify of Japan, South Korea, and Taiwan, article 36 of the Japanese *Law of Trusts* provides:<sup>122</sup>

- (1) With regard to the taxes, public dues, and other expenses which the trustee has borne with respect to the trust property, or with regard to the compensation of losses which the trustee has suffered in connection with the management of trust affairs without negligence on his or her part, the trustee may sell the trust property and satisfy his or her claim in preference to other claimants.
- (2) The trustee may demand of the beneficiary either reimbursement or imbursement or indemnification, or furnishing of reasonable security, with respect to the expenses and losses mentioned in the preceding paragraph, provided however, that this shall not apply in cases where the beneficiary in question is not yet *in esse*.<sup>123</sup>
- (3) The provisions of the preceding paragraph shall not apply in cases where the beneficiary has waived his/her rights.

In respect of the right of indemnity against the beneficiaries personally, the provisions of the *Law of Trusts* of ROC differ from those of Japan and South Korea. In Taiwan, article 40 of the *Law of Trusts* of ROC provides clearly that the trustee shall exercise the right only in the case where the trust assets are insufficient to indemnify him/her.<sup>124</sup> However, such right shall be exercised within two years, or it will be extinguished by

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<sup>122</sup> . See also the South Korean *Law of Trusts*, article 42; the *Law of Trusts* of ROC, article 39, 40, 42.

<sup>123</sup> . See section 3.2.3.2 “certainty of objects under the Civil Law” of this thesis.

<sup>124</sup> . The *Law of Trusts* of ROC, article 40 (1).

virtue of lapse of time.<sup>125</sup> Where the trust instrument provides that the trustee may demand of the beneficiary either reimbursement, or indemnification, or furnishing of reasonable security prior to exercising the right out of the trust assets, such provisions shall prevail.<sup>126</sup> By contrast, in Japan and South Korea, the insufficiency of the trust property to satisfy the trustee's right of indemnity is not a prerequisite of exercising the right against the beneficiary personally. Rather, a trustee may elect to exercise his/her right of indemnity either against the trust property or against the beneficiary personally. Comparing the above provisions between the *Law of Trusts* of Japan, South Korea and Taiwan, those of Taiwan are more reasonable.

Apart from providing that a trustee may claim his/her right of indemnity out of trust assets or against the beneficiaries personally, article 42 of the *Law of Trusts* of ROC provides that: "a trustee may refuse to deliver the trust property to the beneficiary before his/her right of indemnity has been satisfied". This provision stems from the Common Law. For example, in *Chief Commissioner of Stamp Duties v Buckle*, the High Court of Australia held:<sup>127</sup>

In aid of that right to reimbursement or exoneration for liabilities properly incurred in the administration of the trust, the trustee cannot be compelled to surrender the trust property to the beneficiaries until the claim has been satisfied.

With respect to the trustee's right of indemnity, the *Law of Trusts* of ROC made a fatal mistake which may have been caused by carelessness in the course of drafting. Article 39 (1) and (2) of this *Law* provides that "the trustee is entitled to pay the expenses, taxes, or debts, which are incurred by the trustee in the course of conducting trust, out of

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<sup>125</sup> . Ibid, article 40 (3).

<sup>126</sup> . Ibid. article 40 (2).

<sup>127</sup> . (1998) 151 ALR 1 at 13 (per Brennan CJ, Toohey, Gaudron, McHugh and Gummow JJ who delivered a joint judgement).

the trust assets in preference to other general creditors”, and article 39 (3) provides that “the expenses, taxes or debts cannot be paid out of the trust assets if the trustee conducts trust affairs in violation of the trust purpose”. Although article 39 (3) does not clearly provide that the trustee shall bear the liabilities him/herself, it impliedly bears that meaning.<sup>128</sup> However, article 40 (1) of the *Law* provides:

Where the trust assets are insufficient to satisfy the expenses or debts mentioned in the Paragraph (1) of the preceding Article or where the trustee falls within the circumstances of Paragraph (3) of the preceding Article, the trustee may demand of the beneficiary to reimburse, to compensate, or furnish security, except that however, it is otherwise provided by the trust act.

Since article 39 (3) provides that a trustee who conducts the trust affairs in violation of trust purpose cannot exercise the right of indemnity from the trust assets, how can article 40 (1) provide that the trustee can exercise the right of indemnity against the beneficiary personally although he/she cannot be indemnified out of the trust assets by virtue of acting in violation of the trust purpose? It is a seriously contradictory provision. It is hoped that this mistake is only an oversight, and it is to be hoped that it will be corrected soon.

#### **3.1.4.2.2 The right of remuneration**

As a general principle, a trustee who does not conduct the trust as a business shall not receive remuneration. However, a trustee other than a business trustee can receive remuneration if it is provided by the trust instrument or by any other agreement entered by the trust parties when or after the trustee accepts the trust.

Article 35 of the Chinese *Law of Trusts* provides:

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<sup>128</sup> . See the explanations to the article 41 of the Draft of the Law of Trusts of ROC (1993).

- (1) A trustee is entitled to the remuneration in accordance with the provisions of the trust instrument. Where there is no such provision in the trust instrument, the trust parties may agree upon the remuneration after the trustee accepts the trust. Where there is no provision or agreement for remuneration when or after the trustee accepts the trust, the trustee shall not receive remuneration.
- (2) The amount of the agreed remuneration may be increased or reduced by the trust parties through negotiation.

This article does not distinguish between the general trustees and the professional trustees who take on the role of trustee for remuneration. It provides that whether the trustee can receive remuneration or not shall be decided by the trust instrument or by the agreement between the trust parties. In addition, article 35 of the *Law* does not provide that whether the trustee is entitled to receive remuneration out of trust assets. It is suggested that if there are no provisions in the trust instrument or in the agreement as to whether the trustee can receive remuneration out of trust assets, the trustee should be entitled to be reimbursed out of trust assets as well as against the beneficiaries personally.

In Japan, South Korea and Taiwan, the business trustees, who take the trust as their business, are entitled to receive remuneration, while other trustees can receive remuneration only where there is special stipulation. For example, article 35 of the Japanese *Law of Trusts* provides:<sup>129</sup>

A trustee shall not be entitled to remuneration unless there is special stipulation to that effect, except when the trust has been accepted as a business.

With respect to the amount of remuneration, the Japanese and South Korean *Law of Trusts* do not provide clearly whether the trust parties can agree to increase or reduce the amount after the trustee accept the trust. However, in the light of the general principle of

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<sup>129</sup> . See also the South Korean *Law of Trusts*, article 41; the *Law of Trusts* of ROC, article 38 (1).

the civil juristic act that the parties to a juristic act have the freedom to vary the terms of the act, the trust parties can also increase or reduce the remuneration by agreement.

In Taiwan, article 38 (2) of the *Law of Trusts* of ROC provides that the trust parties cannot increase or reduce the remuneration by agreement themselves and they have only the right to apply to the court to vary the amount of remuneration under the circumstances where the remuneration has become “obviously unfair”. It is thought that the provisions are too harsh. So long as the trust parties agree upon varying the remuneration on the basis of voluntariness and fairness, they should be entitled to do so.

### **3.1.4.2.3 The right of contribution from co-trustees**

All the trusts law of Japan, South Korea, Taiwan and China only provide that the co-trustees shall bear the joint and several liabilities to the beneficiary and the third party,<sup>130</sup> but they do not clearly provide the right of contribution from the co-trustees. However, under the civil law, because the joint obligors are liable for their obligations jointly and severally, one of the joint obligors is entitled to claim the contribution from the other joint obligors of their shares after he/she has performed the obligation. For example, article 87 of the Chinese GPCL provides:<sup>131</sup>

Where there are two or more joint obligees or joint obligors, each of the joint obligee is entitled to demand any of the joint obligors of performing obligations in accordance with legal provisions or agreement between the parties; and each of the joint obligor is liable for performing the entire obligations. Where one of the joint obligors has performed the entire obligations, he/she is entitled to claim the other joint obligors to reimburse him/her for their shares of the obligations.

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<sup>130</sup> . The Japanese *Law of Trusts*, article 25; the South Korean *Law of Trusts*, article 46; the Chinese *Law of Trusts*, article 32; and the *Law of Trusts* of ROC, article 43.

<sup>131</sup> . See also the Japanese *Civil Code*, article 442; the *Civil Code* of ROC, article 281.

Thus, it is suggested that it should be better for the Chinese *Law of Trusts*, following the provisions of the Chinese GPCL, to provide clearly that a co-trustee is entitled to reimburse him/her from other co-trustees after he/she has discharged the liabilities incurred in the course of conducting trust affairs. However, like the right of contribution under the Common Law, the Chinese *Law of Trusts* shall also provide that the right of contribution cannot be exercised against the innocent co-trustees.

## **3.2 The Settlor and the Beneficiary**

### **3.2.1 The Settlor and the Beneficiary under the Common Law**

In order to create an express trust either by a declaration of intention *inter vivos* or by a will the settlor or the testator/testatrix must have legal capacity. However, after the trust is created, the creator can hardly do anything to deal with the trust. Although a settlor can reserve rights in the trust instrument to retain some influence in relation to the trust property and the trustee, the settlor is not recognized as a party of the trust because he/she does not enjoy any rights nor bear any liabilities. Thus, this Section of this Chapter merely deals with the beneficiary. Again, because the certainty of the beneficiary has been discussed in the Chapter two of this thesis, this Section only examines the rights of a beneficiary.

The basic and most important right of a beneficiary is to obtain the beneficial interest in the trust property. This right is also the purpose of creating a trust and all the other rights are subject to this right. However, in order to achieve the trust purpose, the beneficiary may need to exercise other rights. Generally, the duties and liabilities of a

trustee which were discussed above are the rights of a beneficiary. Apart from those rights corresponding to the duties and liabilities of a trustee, a beneficiary also has mainly the following rights.

### **3.2.1.1 Right to extinguish the trust**

A beneficiary, who is *sui juris* and absolutely entitled to the trust property, has the right to extinguish the trust by directing the trustee to transfer the trust property to him/her. This rule was firmly established by the decision in *Saunders v Vautier*.<sup>132</sup> The rule also applies where there are several beneficiaries so long as the beneficiaries are also *sui juris* and absolutely entitled to the trust property and unanimously agree to terminate the trust.<sup>133</sup> Again, the rule applies to the beneficiaries of a discretionary trust so long as the beneficiaries can be identified, the class of beneficiaries is closed and the trustee is liable to distribute income every year.<sup>134</sup>

In *Quinton v Proctor*,<sup>135</sup> it was held that the beneficiaries may elect to terminate the trust only partially by calling for the trustee to transfer to them only a part of the trust property. In that case, Kellam J states:<sup>136</sup>

The further rule is that where one beneficiary is entitled absolutely to an aliquot share of a trust fund, unless a contrary intention appears, that beneficiary is entitled to call for payment or transfer of that share to him. The effect of this is to terminate the trust, but only in relation to that share.

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<sup>132</sup> . (1841) 4 Beav 115; 49 ER 282.

<sup>133</sup> . *Gosling v Gosling* (1859) Johns 265; 70 ER 423.

<sup>134</sup> . *Sir Moses Montefiore Jewish Home v Howell & Co (No 7) Pty Ltd* [1984] 2 NSWLR 406.

<sup>135</sup> . [1998] 4 VR 469.

<sup>136</sup> . *Ibid*, at 471.

In giving his reasons for the above decision, Kellam J stated: “If beneficiaries entitled in succession may combine to terminate a trust in its entirety, I can see no reason in principle why they should not be entitled to combine to terminate a trust in respect of aliquot shares or parts thereof”.<sup>137</sup>

Therefore, the beneficiaries, who are absolutely entitled to the trust property and are all of full legal capacity, are entitled to terminate the trust entirely or partially by calling for the trustee to transfer the whole or part of the trust property to them.

However, although the beneficiaries who are sui juris and absolutely entitled to the trust property can terminate the trust unanimously by directing the trustee transferring the trust property to them, they cannot direct the trustee as to the execution of the trust if they do not want to terminate the trust.<sup>138</sup>

### **3.2.1.2 Right to compel performance**

A trustee is under the duty to administer the trust business. Where the trustee is in breach of his/her duties, any beneficiary or beneficiaries are entitled to bring action to court to compel the trustee to perform his/her duties so as to protect their beneficial interests.<sup>139</sup>

A beneficiary or beneficiaries are entitled not only to bring an action against the trustee, but also to bring an action against third parties, against whom the trustee refuses to institute proceedings on behalf of the trust or the trustee is prevented to institute such proceedings by virtue of the conflict of interests.<sup>140</sup>

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<sup>137</sup> . Ibid, at 474.

<sup>138</sup> . *Re Brockbank* [1948] 1 Ch 206.

<sup>139</sup> . *Bartlett v Bartlett* (1845) 4 Hare 631; 67 ER 800.

<sup>140</sup> . *Hayim v Citibank NA* [1987] AC 730.

### 3.2.1.3 Right to trace trust property

Tracing is the process to follow one's property. Ong states that "tracing is the process whereby an owner of property is able to continue to identify that property as his own, notwithstanding that it may have undergone a series of transformations".<sup>141</sup> In *Foskett v Mckeown*,<sup>142</sup> Lord Millett stated that:<sup>143</sup>

Tracing is thus neither a claim nor a remedy. It is merely the process by which a claimant demonstrates what has happened to his property, identifies its proceeds and the persons who have handled or received them and justifies his claim that the proceeds can properly be regarded as representing his property.

Although Lord Millett said that tracing was not a remedy, it is commonly thought that tracing is a remedy available both at common law and in equity. In other words, tracing is the process of obtaining the remedy. The common law tracing is distinct from equitable tracing. Where an item of property is physically mixed with other property belonging to other persons or converted into another form of property, equity allows the owner of the item of property to follow that property;<sup>144</sup> while at common law, once the property becomes physically mixed with property belonging to other persons, tracing becomes impossible and the owner only retains a right of compensation.<sup>145</sup> Because of the proprietary nature of tracing, the most important advantage of tracing is that the property can be traced into the assets of a person who is bankrupt.

Thus, where the trust property is taken by the trustee or other third parties in breach of the trustee's duties, the beneficiary has the right to trace that trust property into the hands of the trustee or the third parties no matter in its original form or converted form.

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<sup>141</sup> . Denis Ong: *Trusts Law in Australia* (2003, 2<sup>nd</sup> ed), p 643.

<sup>142</sup> . [2000] 3 All ER 97.

<sup>143</sup> . Ibid at 120.

<sup>144</sup> . *In re Hallett's Estate* (1880) 13 Ch D 696; *Brady v Stapleton* (1952) 88 CLR 322.

<sup>145</sup> . *Taylor v Plumer* (1815) 3 M & S 562; 105 ER 721.

## 3.2.2 The Settlor and the Beneficiary under the Civil Law

### 3.2.2.1 *The position of the settlor*

#### 3.2.2.1.1 The vague position of the settlor in Japan, South Korea and Taiwan

According to the definition of the trust under the Civil Law, a trust means the settlor transfers property rights to the trustee who administers the trust property for the benefit of the beneficiary.<sup>146</sup> In addition, because an express trust *inter vivos* is created by contract, it is undoubted that the settlor of an express trust *inter vivos* is one of the parties to the trust. However, the *Law of Trusts* in Japan, South Korean and Taiwan do not clearly state that a settlor is a party to the trust although they vest in the settlor many rights.

The Japanese *Law of Trusts* does not have any article which deals specifically with the settlor, although the rights of the settlor are involved in some articles. The South Korean *Law of Trusts* adopts one chapter, Chapter Two, to provide for the trust parties. However, the whole Chapter only provides for the capacity, the appointment, the retirement and the resignation of the trustee and the appointment of the trust administrator. The *Law* also uses Chapter 3 and Chapter 4 to provide for the rights and duties of the trustee and the beneficiary respectively, but no articles are employed specially to provide for the settlor. Likewise, the *Law of Trusts* of ROC specifically adopts three chapters, Chapter 3, Chapter 4, and Chapter 5 to provide for the beneficiary,

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<sup>146</sup> . The Japanese *Law of Trusts*, article 1; the South Korean *Law of Trusts*, article 1 (2); the Chinese *Law of Trusts*, article 2; the *Law of Trusts* of ROC, article 1.

the trustee and the trust administrator respectively, but does not provide for the settlor with a particular chapter or even a single article. The rights of the settlor are provided for by relevant articles sporadically. In Taiwan, apart from the settlor, the trustee, the beneficiary, and the trust administrator are also regarded as important parties to a trust by scholars.<sup>147</sup>

From the viewpoint of legislative techniques, it is an error not to provide for the status of the settlor clearly with special section while recognizing a settlor as a party to a trust.

### **3.2.2.1.2 The position of the settlor under the Chinese Law of Trusts**

Unlike its counterparts in Japan, South Korea and Taiwan, the Chinese *Law of Trusts* clearly states that the settlor is a party to the trust by enacting a specific section to provide for the status of the settlor. Chapter Four of the Chinese *Law of Trusts* is about trust parties and Section One (article 19 to article 23) of the Chapter specifically provides for the capacity and the rights of a settlor. Article 19 of the *Law* provides: “A settlor shall be a natural person with full legal capacity, a legal person or an organization which is of full legal capacity and is set up in accordance with law”. Other articles of the Section provide for the rights of a settlor. In addition, the *Law* also provides for other rights of the settlor in some relative parts or articles, such as the right of a settlor to set aside the trust.

### **3.2.2.2 Rights of the settlor and the beneficiary**

The settlor and the beneficiary of a trust *inter vivos* share some rights. The *Law of Trusts* in Japan, South Korea and Taiwan provide for the rights of the settlor in different articles, while the Chinese *Law of Trusts*, from article 20 to article 23, collectively

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<sup>147</sup> . Lai Yuanhe & Wang Zhicheng: *On Modern Law of Trusts* (2000, 2<sup>nd</sup>), p 45; Cheng Chunshan: *Special Comments on Trust and Business Trusts – Theory and Practice* (2000, 3<sup>rd</sup>), p 63.

provides for the rights enjoyed by the settlor. In addition, article 49 (1) of the Chinese *Law of Trusts* provides that the beneficiary can also exercise the same rights of the settlor provided for by the *Law* from article 20 to article 23 and that either of the settlor or the beneficiary may apply to the court to make a decision if they do not agree with each other in respect of exercising the rights provided for from article 20 to article 23 of the Chinese *Law of Trusts*.

Moreover, other articles of the Chinese *Law of Trusts* provides for some rights to be shared by the settlor and the beneficiary.

Apart from the rights enjoyed by both the settlor and the beneficiary, the settlor and the beneficiary also enjoy some separate rights respectively by virtue of their different status in a trust.

### **3.2.2.2.1 The rights shared by the settlor and the beneficiary**

According to the *Law of Trusts* of Japan, South Korea, Taiwan and China, a settlor and a beneficiary mainly share the following rights.

#### ***The right to raise objection to compulsory execution***

Article 17 of the Chinese *Law of Trusts* provides that no compulsory execution shall be levied on the trust property except for a right which arises on the trust property prior to the creation of the trust, a right which arises in the course of administering trust affairs, or a right of tax levied on the trust property; otherwise, the settlor, the trustee or the beneficiary is entitled to raise an objection to the compulsory execution.<sup>148</sup>

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<sup>148</sup> . See also: the Japanese *Law of Trusts*, article 16; the South Korean *Law of Trusts*, article 21; the *Law of Trusts* of ROC, article 12.

***The right to demand an explanation as to the conduct of the trust affairs and to examine trust accounts of the trust property and other documents relative to the conduct of the trust affairs***

Article 20 of the Chinese *Law of Trusts* provides that:

- (1) The settlor is entitled to know the revenue and expenditure, the management, disposal of the trust property, and to demand the trustee for the explanation of the trust as to the conduct of the trust affairs.
- (2) The settlor is entitled to examine, to note down, and to copy trust accounts of the trust property and other documents relative to the conduct of the trust affairs.

The *Law of Trusts* of Japan, South Korea and Taiwan have similar provisions as to these rights of the settlor and the beneficiary.<sup>149</sup>

***The right to demand the trustee to change the methods of administering the trust property***

Where the method of administering the trust property has become inappropriate, the settlor and the beneficiary may ask the trustee to change the method or apply to the court to change it. However, the provisions of the *Law of Trusts* in Japan, South Korea, Taiwan and China are different to some extent. In China, the settlor and the beneficiary are entitled to demand that the trustee adjust the method of administering the trust property.

Article 21 of the Chinese *Law of Trusts* provides:

Where the method of administering the trust property has become inappropriate for the purpose of the trust or inappropriate for the benefits of the beneficiary by reason of special circumstances which could not be foreseen at the time of the creation of the trust, the settlor has the right to demand that the trustee adjust the methods of administering the trust property.

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<sup>149</sup> . The Japanese *Law of Trusts*, article 40; the South Korean *Law of Trusts*, article 34; the *Law of Trusts* of ROC, article 32.

In Japan, according to article 23 (1) of the Japanese *Law of Trusts*,<sup>150</sup> the settlor and the beneficiary only have the right to apply the court to ask the trustee to change the method of the administration of the trust property if it has become inappropriate for the benefit of the beneficiary by reason of specific circumstances which could not be foreseen at the time of the creation of the trust.

In Taiwan, article 15 of the *Law of Trusts* of ROC provides: “The settlor, the trustee and the beneficiary may agree with changing the method of administering trust property”. Following article 15, article 16 of the *Law* provides the trust parties may apply the court to change the method of administering the trust property if it has become inappropriate by reason of the fundamental change of the circumstances.

With respect to the right to demand from the trustee a change in the method of administering the trust property, the provisions of the Chinese *Law of Trusts* are too harsh on the trustee because it is easy for the settlor or the beneficiary to abuse the right to interfere the trustee with his/her administration of trust affairs. The provisions of the *Law of Trusts* of ROC are more reasonable and practicable. It is suggested that the Chinese *Law of Trusts* should follow the provisions of the *Law of Trusts* of ROC to allow the trust parties, namely the settlor, the beneficiary and the trustee, to reach an agreement upon the change of the method of administering the trust property and to allow anyone of them to apply to the court to change the method if the method has been no longer appropriate for the benefits of the beneficiary.

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<sup>150</sup> . The South Korean *Law of Trusts*, article 36 (1).

***The right to apply to the court to avoid the disposal of the trust property and the right to demand that the trustee restore the trust property or compensate for the losses***

Where the trustee disposes of the trust property in violation of the trust purpose or inflicts losses upon the trust property by virtue of mismanagement or breach of his/her duties, the settlor and the beneficiary are entitled to apply to the court to avoid the trustee's act of disposal and to demand that the trustee restore the trust property or to demand that the trustee compensate for the losses. Article 22 of the Chinese *Law of Trusts* provides:

- (1) Where a trustee has disposed of the trust property in violation of the trust purpose, or has inflicted losses upon the trust property through mismanagement or breach of the duties of a trustee, the settlor has the right to apply the court to avoid the disposal act of the trustee and to demand of the trustee for the indemnification of losses or the restitution of trust property. Where the transferee has known that he/she has received the trust property in violation of the purpose of the trust, he/she shall return the trust property that he/she has already received or indemnify the losses.
- (2) The right of avoidance provided by the preceding paragraph shall be extinguished within one year from the day when the settlor knows or should know the reasons for the rescission.

The *Laws of Trusts* of Japan, South Korea and Taiwan also provide that the settlor, his/her heir, the beneficiary, and other trustees may demand of the trustee indemnification of losses or restitution of the trust property if the trustee causes losses to the trust property through mismanagement, breach of his/her duties, or disposal of the trust property in violation of the trust purpose.<sup>151</sup> However, in respect of the right to avoid the trustee's act of disposal of the trust property in violation of the trust purpose, the provisions of the

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<sup>151</sup> . See the Japanese *Law of Trusts*, article 27; the South Korean *Law of Trusts*, article 38; the *Law of Trusts* of ROC, article 23.

*Laws of Trusts* of Japan, South Korea and Taiwan are not the same as that of the Chinese *Law of Trusts*. In Taiwan, article 18 (1) of the *Law of Trusts* of ROC provides that only the beneficiary can apply to the court to avoid the trustee's act. In Japan and South Korea, neither the Japanese nor the South Korean *Law of Trusts* provides for the beneficiary to apply to the court to avoid an act of the trustee, but the *Laws* provide that the beneficiary has the direct right of avoidance. For example, article 31 of the Japanese *Law of Trusts* provides:<sup>152</sup>

In cases where the trustee disposes of the trust property in contravention of the tenor of the trust, the beneficiary may avoid such disposal as against the other party or subsequent acquirers, provided however, that this shall apply only in case there has been registration or recordation of the trust, or in cases where, with respect to trust properties that are not to be registered or recorded, the other party and sub-acquirers, had known or failed to know because of gross negligence that the disposition in question was in contravention of the tenor of the trust.

Where a trustee inflicts losses upon the trust property through mismanagement, in breach of his/her duty, or in violation of trust purpose, the victim is the beneficiary rather than the settlor. Accordingly, it should be the beneficiary rather than the settlor who has the right to demand that the trustee indemnify against the losses or restore the trust property. However, since the Civil Law jurisdictions confer on the settlor and his/her heir the same right of the beneficiary, it is difficult to understand why the *Law of Trusts* of Japan, South Korea and Taiwan do not allow the settlor to have also the right to apply to the court to avoid the trustee's act to disposes of the trust property in violation of the trust purpose.

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<sup>152</sup> . See also: the South Korean *Law of Trusts*, article 52; the *Law of Trusts* of ROC, article 18.

***The right to dismiss the trustee in accordance with the terms of the trust or to apply to the court to dismiss the trustee***

Article 23 of the Chinese *Law of Trusts* provides: “Where the trustee disposes of the trust property in violation of the trust purpose, administers the trust property with gross negligence, the settlor is entitled to dismiss the trustee under the terms of the trust instrument or to apply to the court to dismiss the trustee”. The *Law of Trusts* of Japan, South Korea and Taiwan have similar provisions, but there are two points which are not the same as the provisions of article 23 of the Chinese *Law of Trusts*. One is that the reasons for dismissing the trustees are different. These *Laws of Trusts* provide that if the trustee acts in breach of his/her duties or if there are other important reasons, the court may dismiss the trustee upon the application of the settlor. The other is that the settlor can only have the right to apply to the court to dismiss the trustee. For example, article 47 of the Japanese *Law of Trusts* provides:<sup>153</sup>

In cases where a trustee commits a breach of his/her duties or where there exist other important reasons, the Court may, upon application of the settlor, his or her heirs, or the beneficiary, dismiss the trustee from his/her office.

***The right to appoint new trustee***

According to article 39 (1) and article 40 (1) of the Chinese *Law of Trusts*, where the trustee’s office is terminated by virtue of death, bankruptcy, retirement, resignation, incompetent, dismissal, or dissolution, the settlor is entitled to appoint a new trustee or new trustees; where the settlor is unable or unwilling to appoint a new trustee or new trustees, the beneficiary has the right to appoint.

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<sup>153</sup> . See also: The South Korean *Law of Trusts*, article 15; the *Law of Trusts* of ROC, article 36 (2).

In Japan and South Korea, the settlor and the beneficiary have no right to appoint a new trustee, but they may apply to the court for the appointment of a new trustee.<sup>154</sup>

In Taiwan, according to article 36 of the *Law of Trusts* of ROC, where the office of a trustee is terminated by reason of the resignation or dismissal of the trustee, a new trustee shall be appointed by the settlor; where the settlor is unable or unwilling to appoint a new trustee, the court may appoint a new trustee or new trustees on the application of any interested person (included beneficiary) or of the prosecutor.

### **3.2.2.2 The separate rights of the settlor and the beneficiary**

#### ***The separate rights of the settlor***

The settlor has some rights which the beneficiary cannot enjoy. The most important separate right of the settlor is the right to change the beneficiary or the beneficiaries, to dispose of the beneficial interests of the beneficiary, or to set aside the trust.<sup>155</sup> In addition, the settlor is entitled to revoke the trust if he/she is the sole beneficiary of a trust.<sup>156</sup> The above two rights of the settlor will be discussed in detail in next chapter (“Variation and the Termination of Trusts”) of this thesis.

Moreover, the settlor may reserve in the trust instruments other rights. According to the general principles of trusts law, the settlor can reserve rights in the trust instruments, such as the replacement and appointment of trustee, the variation of the trust and the avoidance of the trust. If such reservation of rights does not contravene the law, it shall be applied.

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<sup>154</sup> . The Japanese *Law of Trusts*, article 49 (1); the South Korean *Law of Trusts*, article 17 (1).

<sup>155</sup> . The Chinese *Law of Trusts*, article 51.

<sup>156</sup> . *Ibid*, article 50.

### ***The separate rights of the beneficiary***

Apart from the rights enjoyed by the beneficiary and the settlor commonly, like the settlor, the beneficiary also enjoys some separate rights.

First, the beneficiary enjoys the right to the beneficial interest. It is the most significant right of the beneficiary as well as the purpose of creating a trust. Article 44 of the Chinese *Law of Trusts* provides that “the beneficiary enjoys the right to the beneficial interest on the day when the trust takes effect except that it is otherwise provided by the trust instrument”.<sup>157</sup> In respect of co-beneficiaries, they enjoy their rights to the beneficial interest in accordance with the terms of the trust instrument. If the trust instrument does not provide for the distribution of the proportion of beneficial interest nor provide for the distribution methods, the co-beneficiaries enjoy the beneficial interest equally.<sup>158</sup>

Secondly, the beneficiary may disclaim the right to the beneficial interest although he/she enjoys such right automatically after the creation of trust. Article 46 (1) of the Chinese *Law of Trusts* provides that “the beneficiary may disclaim his/her right to the beneficial interests”.<sup>159</sup> “Where all the beneficiaries disclaim their rights to the beneficial interests, the trust is terminated”.<sup>160</sup>

Thirdly, the beneficiary is entitled to pay his/her debts with beneficial interest. Article 47 of the Chinese *Law of Trusts* provides:

Where a beneficiary cannot pay his/her due debts, he/she may pay the debts with beneficial interest, except it is otherwise provided by the laws and administrative rules or by the trust instrument.

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<sup>157</sup> . See also: the Japanese *Law of Trusts*, article 7; the South Korean *Law of Trusts*, article 51; the *Law of Trusts* of ROC, article 17.

<sup>158</sup> . The Chinese *Law of Trusts*, article 45.

<sup>159</sup> . See also the South Korean *Law of Trusts*, article 51 (3); the *Law of Trusts* of ROC, article 17 (2).

<sup>160</sup> . The Chinese *Law of Trusts*, article 46 (2).

Fourthly, the beneficiary is entitled to assign his/her right to the beneficial interest and such right can be inherited by his/her heirs. Article 48 of the Chinese *Law of Trusts* provides:<sup>161</sup>

A beneficiary's right to the beneficial interest may be assigned and succeeded, except that it is otherwise provided in the trust instrument.

It is suggested that apart from the assignment and the succession of the right to the beneficial interest, the beneficiary should also create a sub-trust for the beneficial interest.

### **3.2.2.3 Duties of the settlor and the beneficiary**

The *Law of Trusts* of China, Japan, South Korea and Taiwan do not clearly provide for the duties of a settlor and the beneficiary. However, according to the general principles of the trusts law, both the settlor, who enjoys most of the rights of a beneficiary under the Civil Law, and the beneficiary are under a general duty not to interfere with the trustee in the performance of his/her duties and powers, unless the trustee administers the trust affairs in violation of the trust purpose or in breach of the trust.

In addition, the beneficiary is also under the duty not to direct the trustee as to the execution of the trust unless the beneficiary, who is entitled to terminate the trust, elects to extinguish the trust.

Moreover, under certain circumstance, the settlor is under the duty to transfer the trust property to the trustee if the trust is created for valuable consideration. As discussed in preceding chapter of this thesis, a voluntary trust cannot be validly created without the transfer the trust property. A donor cannot be compelled to transfer the property to the donee to constitute a voluntary trust. However, if the trust is created for valuable consideration, it is completely constituted even the trust property has not been transferred

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<sup>161</sup> . See also the *Law of Trusts* of ROC, article 20.

from the settlor to the trustee. Thus, in this case the settlor has the duty to transfer the trust property.

Apart from performing their duties, the beneficiary is also liable to indemnify the trustee. The *Law of Trusts* of Japan, South Korea and Taiwan provide that the trustee is entitled to indemnify him/her against the beneficiary personally.<sup>162</sup> Although the Chinese *Law of Trusts* does not provide for the liability of the beneficiary, it is suggested that the Chinese *Law of Trusts* should follow its counterparts in Japan, South Korea, and Taiwan to impose such liability on the beneficiary.

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<sup>162</sup> . The Japanese *Law of Trusts*, article 36; the South Korean *Law of Trusts*, article 42; the *Law of Trusts* of ROC, article 39, 40 and 41.

## **Chapter 4**

### **Variation and Termination of Trusts**

Under both the Common Law and the Civil Law, a trust must be administered for the benefit of the beneficiary in accordance with the terms of the trust. It cannot be varied or terminated by the trust parties or by the court unless it was otherwise provided by the trust instrument or in special circumstances. A trust will terminate naturally if the purpose or the period of the trust prescribed by the terms of the trust has been achieved or has expired. A trust may also be terminated by the trust parties or by the court before the achievement of the trust purpose or before the expiration of the trust in certain circumstances. In addition, a trust can even be declared void by the court if it is illegal.

Variation and termination of trusts were partly discussed in the preceding chapter of this thesis, which deals with the duties and rights of the trust parties. This Chapter will discuss the question in more detail. However, this Chapter neither deals with the variation and termination caused by illegality or by infringement of the public policy, nor the natural termination, namely the termination by virtue of the achievement and the expiration of the trust prescribed by the trust instruments. This Chapter deals only with variation and termination by the trust parties or by the court before the trust ends naturally.

## **4.1 Variation and Termination of Trusts under the Common Law**

It is a general principle under the Common Law that once a trust is created, the settlor, the trustee, and the beneficiary cannot vary or revoke it unless it is otherwise provided in the trust instrument. However, in certain circumstances, a trust can be varied or terminated by the settlor, the beneficiary, the trustee, or the court. In addition, the settlor can vary or terminate the trust if he/she reserves the power of variation or revocation of the trust in the trust instrument.

### **4.1.1 Variation and Termination by the Settlor, the Beneficiary and the Trustee**

#### ***4.1.1.1 Variation and termination by the settlor***

It is a general rule in England and in Australia that a settlor is entitled to vary or revoke a trust if he/she reserves to himself/herself such a power in the trust instrument. If the settlor does not reserve a power of variation or revocation, he/she cannot vary or revoke the trust.

In the United States, a settlor also has the power to revoke or modify a trust if he/she reserves such a power in the trust instrument.<sup>1</sup>

However, in the United States, even if the settlor did not reserve such a power by omission, he/she still has the power to revoke or modify the trust. Section 332 of the *Restatement of Trusts 2d* provides:

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<sup>1</sup> . *Restatement of Trusts 2d*, ss 330 (1), 331 (1).

- (1) If a trust is created by a written instrument and the settlor intended to reserve a power of revocation but by mistake omitted to insert in the instrument a provision reserving such a power, he can have the instrument reformed and can revoke the trust.
- (2) If a trust is created by a written instrument and the settlor intended to reserve a power to modify the trust but by mistake omitted to insert in the instrument a provision reserving such a power, he can have the instrument reformed and can modify the trust.

Again, section 338 of the *Restatement of Trusts 2d* provides that the settlor may, together with the consent of the beneficiary, terminate or modify the trust.

In addition, if the settlor is the sole beneficiary, he/she can select to terminate the trust. Section 339 of the *Restatement of Trusts 2d* provides:

If the settlor is the sole beneficiary of a trust and is not under an incapacity, he can compel the termination of the trust, although the purposes of the trust have not been accomplished.

#### **4.1.1.2 Variation and termination by the beneficiary**

In England and Australia, the rule in *Saunders v Vautier*<sup>2</sup> is adopted to deal with the termination of the trust by the beneficiaries. According to the rule, the beneficiaries of a trust have the right to terminate the trust if they all are of full legal capacity and are together absolutely entitled to the trust property.

In the United State, the adoption of the rule in *Saunders* is conditional. For example, section 337 of the *Restatement of Trusts 2d* provides:

- (1) Except as stated in Subsection (2), if all of the beneficiaries of a trust consent and none of them is under an incapacity, they can compel the termination of the trust.
- (2) If the continuance of the trust is necessary to carry out a material purpose of the trust, the beneficiaries cannot compel its termination.

It is difficult to understand the “material purpose” prescribed by section 337 (2) of the *Restatement of Trusts 2d*. Logically, the material purpose of every trust should be for the interest of the beneficiary or beneficiaries. Since the material purpose of a trust

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<sup>2</sup>. (1841) 4 Beav 115; 49 ER 282.

is for the interest of the beneficiaries, the beneficiaries can select to terminate the trust. However, because of the subsection (2), it seems that there was another material purpose in a trust which is contrary to the interest of the beneficiary or to which the interest of the beneficiaries was subject.

In addition, according to the spirit of the rule in *Saunders*, in England and Australia, if one or more of the beneficiaries who are of full capacity do not consent to bring an end to the trust or one or more of the beneficiaries are under incapacity, the trust cannot be terminated.

In the United States, although section 340 (1) of the *Restatement of Trusts 2d* also provides that “one or more of the beneficiaries of a trust do not consent to its termination or are under an incapacity, the others cannot compel the termination of the trust”, there are two exceptions to this provision. The first exception is provided for by section 338 (2) of the *Restatement of Trusts 2d*. Namely, although one or more of beneficiaries do not consent to terminate the trust or they are under an incapacity, the other beneficiaries can still terminate the trust if they consent with the settlor and the termination will not prejudice the interests of those who do not consent to terminate the trust or are under an incapacity. The second exception is provided by section 340 (2) of the *Restatement of Trusts 2d* as follows:

Although one or more of the beneficiaries of a trust do not consent to its termination or are under an incapacity, the court may decree a partial termination of the trust if the interests of the beneficiaries who do not consent or are under an incapacity are not prejudiced thereby and if the continuance of the trust is not necessary to carry out a material purpose of the trust.

Moreover, according to the rule in *Saunders*, since the beneficiaries can terminate the trust if they all are of full legal capacity and are absolutely entitled to the trust property, the rule is also adopted to a sole beneficiary in England and Australia. That means in England and Australia, a sole beneficiary can also terminate a trust so long

as he/she is of full legal capacity and is absolutely entitled to the trust property. However, in the United States, such a beneficiary cannot terminate the trust unless he/she is also the settlor and is not under an incapacity.<sup>3</sup>

Although terminating the trust is the right of beneficiaries who are of full legal capacity and are together absolutely entitled to the trust property, such beneficiaries, usually, have no right to vary a trust in that they cannot direct the trustee as to the execution of trust.<sup>4</sup> If the beneficiaries could vary the terms of the trust, it would amount to direct the trustee to administer the trust. In Australia, it has been held that where trustees were asked by beneficiaries who were of legal capacity and together were absolutely entitled to the trust property to depart from the terms of the trust, the trustees would be permitted, but would not be obligated, to do so.<sup>5</sup>

However, in *Butt v Kelson*,<sup>6</sup> the English Court of Appeal held that the beneficiaries who owned shares in a company could direct the trustees of those shares how to vote. In New Zealand, it was held that where all of the beneficiaries of a pension scheme consent to a variation, the court may under the expediency jurisdiction order that a variation take effect and may give appropriate directions to effect the variation.<sup>7</sup>

In a sense, the partial termination of a trust can be also regarded as a kind of variation of a trust. It can be said that the beneficiaries who are of full capacity and are absolutely entitled to the trust property have varied the trust if they only select to partially terminate the trust by calling for the trustee to transfer part of the trust property to them.<sup>8</sup>

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<sup>3</sup> . *Restatement of Trusts* 2d, s 339.

<sup>4</sup> . *Re Brockbank* [1948] 1 Ch 206.

<sup>5</sup> . *Plimsoll v Drake* (1995) 4 Tas R 334 at 339 (per Zeeman J).

<sup>6</sup> . [1952] 1 Ch 197.

<sup>7</sup> . *Re Phillips New Zealand Ltd* [1997] 1 NZLR 93.

<sup>8</sup> . *Quinton v Proctor* [1998] 4 VR 469.

Apart from the case law, legislation in England and Australia allows a beneficiary to apply to the court to vary or revoke the trust.<sup>9</sup>

#### **4.1.1.3 Variation and termination by the trustee**

In England and Australia, after accepting a trust, the trustee is under a duty to carry out the trust in accordance with the terms of the trust. Any deviation from the trust terms constitutes a breach of trust. Thus, a trustee cannot vary or terminate the trust in violation of the trust instrument.

However, a trustee may be given a power to vary the trust by the trust instrument,<sup>10</sup> or even a power to terminate the trust.<sup>11</sup> A trustee shall exercise the powers given to him in good faith and in accordance with the trust instrument. Where the trustee is given a power of variation, the exercise of the power should not change the “substratum” of the trust.<sup>12</sup> Like a beneficiary, a trustee also has the power to apply to the court to vary or terminate the trust if he/she has not been given such a power.<sup>13</sup>

In the United States, according to section 186 of the *Restatement of Trusts 2d*, a trustee can “properly exercise such powers and only such powers as: (a) are conferred upon him in specific words by the terms of the trust, or are necessary or appropriated to carry out the purpose of the trust and are not forbidden by the terms of the trust”. Thus, a trustee may vary or terminate the trust if he/she is given a power of variation or termination by the trust instrument. However, where the trustee is not given a power of variation or termination by the terms of the trust instrument, “the mere fact

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<sup>9</sup> . *Trustee Act 1925* (UK), s 57 (1) and (3); *Trusts Act 1973* (Qld), s 95; *Trustee Act 1962* (WA), s 90; *Trustee Act 1958* (Vic), s 63A; *Trustee Act 1936* (SA), s 59C; *Trustee Act 1925* (NSW), s 81; *Variation of Trusts Act 1994* (Tas), ss 13-15.

<sup>10</sup> . *Re Cavill Hotels Pty Ltd* [1998] 1 Qd R 396.

<sup>11</sup> . Ford and Lee: *Principles of the Law of Trusts* (1996, 3<sup>rd</sup> ed), § [16040].

<sup>12</sup> . *In re Dyer* [1935] VLR 273; *Ball's Settlement Trusts* [1968] 1 WLR 899.

<sup>13</sup> . *Trustee Act 1925* (UK), s 57 (1) and (3); *Trusts Act 1973* (Qld), s 95; *Trustee Act 1962* (WA), s 90; *Trustee Act 1958* (Vic), s 63A; *Trustee Act 1936* (SA), s 59C; *Trustee Act 1925* (NSW), s 81; *Variation of Trusts Act 1994* (Tas), ss 13-15.

that owing to a change of circumstances not anticipated by the settlor the accomplishment of the purposes of the trust would be defeated or substantially impaired if the trustee were not permitted to exercise a power, does not of itself confer power upon the trustee to act without obtaining the permission of the court, unless there is an emergency such that he has no opportunity to apply to the court for such permission.”<sup>14</sup>

### 4.1.2 Variation and Termination by the Court

In England, traditionally the court has no general inherent power to vary and terminate the trust except in special circumstances. In *Re New*,<sup>15</sup> it was held that the court had an inherent power to vary the terms of the trust in a case, “which may reasonably be supposed to be one not foreseen or anticipated by the author of the trust, where the trustees are embarrassed by the emergency that has arisen and the duty cast upon them to do what is best for the estate, and the consent of all the beneficiaries cannot be obtained by reason of some of them not being sui juris or in existence”.<sup>16</sup>

In *Chapman v Chapman*,<sup>17</sup> the House of Lords held that the court had no inherent jurisdiction to vary the beneficial interests in the trust fund designated by the settlor merely on the basis that such a variation would be beneficial to the beneficiaries or to any one or more of them. However, the court also considered the old cases where the court had changed the terms of trust. The cases were grouped under the following four heads: “(a) cases in which the court has effected changes in the nature of an infant’s property, e.g., by directing investment of his personalty in the purchase of freeholds; (b) cases in which the court has allowed the trustees of settled property to enter into some business transaction which was not authorized by the settlement; (c) cases in

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<sup>14</sup> . Comment c. of §186 of the *Restatement of Trusts 2d*.

<sup>15</sup> . [1901] 2 Ch 534.

<sup>16</sup> . Ibid at 544 (per Romer LJ).

<sup>17</sup> . [1954] AC 429.

which the court has allowed maintenance out of income which the settlor or testator directed to be accumulated; (d) cases in which the court has approved a compromise on behalf of infants and possible after-born beneficiaries”.<sup>18</sup>

Because of the harsh position in respect of the variation and termination of the trust established in *Chapman*, the *Variation of Trusts Act 1958* (UK), which has only three sections, was passed as a result of the recommendations of the Law Reform Committee following the decision in *Chapman v Chapman*<sup>19</sup> and was applied in *Ball's Settlement Trusts*.<sup>20</sup> The Act empowers the court in discretion to approve, on behalf of four groups of persons, any arrangement varying or revoking all or any of the trusts, or enlarging the powers of the trustees of managing or administering any of the property subject to the trusts.

In Australia, the *Variation of Trusts Act 1958* (UK) has been adopted in Tasmania, Queensland, Victoria and Western Australia.<sup>21</sup> Thus, in the four states, the court has the power to vary or revoke any or all of the trust on application of certain persons “if it thinks fit”.

In South Australia, section 59 C of the *Trustee Act 1936* (SA) also provides that “the Supreme Court may, on the application of a trustee, or of any person who has a vested, future, or contingent interest in property held on trust, vary or revoke all or any of the trusts”. However, the exercise of the power by the court provided in this section is more restricted than that provided by its counterparts of above four states. According to section 59 C (3) of the *Trustee Act 1936* (SA), the court shall meet the following requirements before exercise the power of variation and revocation:

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<sup>18</sup> . Ibid at 451.

<sup>19</sup> . [1954] AC 429.

<sup>20</sup> . [1968] 1 WLR 899.

<sup>21</sup> . *Variation of Trusts Act 1994* (Tas), ss 13-15; *Trusts Act 1973* (Qld), s 95; *Trustee Act 1962* (WA), s 90; *Trustee Act 1958* (Vic), s 63A.

- (a) that the application to the Court is not substantially motivated by a desire to avoid, or reduce the incidence of tax;
- (b) that the proposed exercise of powers would be in the interests of beneficiaries of the trust and would not result in one class of beneficiaries being unfairly advantaged to the prejudice of some other class;
- (c) that the proposed exercise of powers would not disturb the trusts beyond what is necessary to give effect to the reasons justifying the exercise of the powers; and
- (d) that the proposed exercise of powers accords as far as reasonable practicable with the spirit of the trust.

In New South Wales, there is no specific section to authorise the variation and termination of trusts. However, according to section 81 of the *Trustee Act 1925* (NSW), the court has a power to vary the trust although it has not a power to terminate the trust like other Australian jurisdictions do. Section 81 (1) of the *Act* provides that where in the course of administering trust property, the court is of the opinion that it is expedient to do so, it may by order confer upon the trustees, either generally or in any particular instance, the necessary powers for the purpose, including adjustment of the respective rights of the beneficiaries, as the court may think fit. Section 81 (2) of the *Act* provides that the provision of section 81 (1) of the *Act* “shall be deemed to empower the court, where it is satisfied that an *alteration* whether by extension or otherwise of the trusts or powers conferred on the trustees by the trust instrument, if any, creating the trust, or by law is expedient, to authorise the trustees to do or abstain from doing any act or thing which if done or omitted by them without the authorisation of the Court or the consent of the beneficiaries would be a breach of trust”.<sup>22</sup>

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<sup>22</sup> . Emphasis added.

However, the power of vary trusts in New South Wales shall be construed in a narrower sense, because it is required to be advantageous to the beneficiaries of the trust as a whole. In *Riddle v Riddle*,<sup>23</sup> Williams J stated that:<sup>24</sup>

The sole question is whether it is expedient in the interest of the trust property as a whole that such an order should be made.

Whilst, in other States, the court can exercise the power of variation and revocation so long as the exercise will be benefit for the persons on whose behalf the power is exercised. For example, section 95 (1A) of the *Trusts Act 1973* (Qld) provides that “the court shall not approve an arrangement on behalf of any person unless the carrying out thereof would be for the benefit of that person”.

## **4.2 Variation and Termination of Trusts under the Civil Law**

### **4.2.1 Variation of Trusts**

In a broad sense, the variation of a trust includes the modification of the terms of the trust and the change of the beneficiary and the trustee, while in a narrow sense, the variation means the variation of the terms of the trust as to the administration of trust and as to the distribution of the beneficial interests. The change of the beneficiary involves the distribution of the beneficial interests. Because the change of the trustee does not fundamentally change the trust purpose and the beneficial interests of the beneficiary, the change of trustee is excluded from the discussion of the variation of the trust.

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<sup>23</sup> . (1952) 85 CLR. 202.

<sup>24</sup> . Ibid at 220.

In Japan and South Korea, the grounds for varying the trust are much narrower. The *Law of Trusts* in Japan and South Korea provide for the variation of the administration provisions of the trust, but the *Laws* do not provide for the variation of the distribution provisions of the trust. In addition, the trust parties cannot change the administration methods by agreement. They can only apply to the court to change it. For example, article 23 (1) of the Japanese *Law of Trusts* provides:<sup>25</sup>

In cases where the method of administering trust property has become inappropriate for the benefits of the beneficiary by reason of special circumstances which could not be foreseen at the time of the act of trust, the settlor, his/her heir, the beneficiary, or the trustee may apply to the court for alteration thereof.

The *Law of Trusts* of ROC, like its counterparts in Japan and South Korea, only provides for the variation of the administration provisions of the trust. Differently, the *Law of Trusts* of ROC provides that the trust parties can change the administration method of the trust property themselves by agreement. Article 15 of the *Law* provides:

The method of administering the trust property can be changed if the settlor, the trustee and the beneficiary agree upon the change.

Meanwhile, article 16 of the *Law of Trusts* of ROC also followed article 23 (1) of the Japanese *Law of Trusts* and article 36 (1) of the South Korean *Law of Trusts*, providing that “the settlor, the beneficiary or the trustee can apply to the court to change the method of administering trust property if the method of administration has become inappropriate for the benefit of the beneficiary by virtue of the change of circumstances”.

The two articles of the *Law of Trusts* of ROC are mutually contradictory. Usually, the settlor, the trustee and the beneficiary can agree upon changing the method of administering the trust property where the method has become improper for the achievement of the trust purpose or for the beneficiary’s beneficial interest. Since the

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<sup>25</sup> . See also the South Korean *Law of Trusts*, article 36 (1).

trust parties can change the method of administering the trust property by agreement, they have the right to change it by agreement so long as they think it is necessary for them to change no matter whether or not there arises any change of circumstances. Thus, article 16 of the *Law of Trusts* of ROC cannot prohibit the trust parties from changing the method of administration by agreement. It is suggested that it should be better for the *Law* to merge the two articles and provide that “the settlor, the beneficiary and the trustee can change the method of administering the trust property by agreement where such method has become inappropriate for the purpose of the trust; where the settlor, the beneficiary and the trustee cannot, or does not want to, reach such an agreement, any of them can apply to the court to change the method of administering the trust property”.

In China, the Chinese *Law of Trusts* provides for the change of both the administrative provisions and distribution provisions of a trust. In respect of the change of administrative provisions, article 21 of the *Law* provides that the settlor is entitled to demand that the trustee adjust the method of administration if such method has become improper for the purpose of the trust or improper for the benefits of the beneficiary by virtue of reasons which cannot be foreseen at the creation of the trust.

With respect to the change of the distribution provisions, the Chinese *Law of Trusts* provides that both the beneficiary and the beneficial interest of the beneficiary can be changed or disposed of in special circumstances. Article 51 of the Chinese *Law of Trusts* provides:

- (1) After the creation of a trust, the settlor may change the beneficiaries or dispose of the beneficial interest of the beneficiary under any of the following circumstances:
  - (a) the beneficiary has committed a serious tort in relation to the settlor;
  - (b) the beneficiary has committed a serious tort in relation to other co-beneficiaries;
  - (c) it is agreed by the beneficiary;

(d) it is otherwise provided in the trust instrument.

(2) The settlor may set aside the trust under the circumstances of (a), (c) and (d) of the preceding paragraph.

It is noteworthy that there are no such provisions in the *Law of Trusts* of Japan, South Korea and Taiwan. In addition, the term “dispose of” adopted in article 51 (1) means, in fact, to revoke the beneficiary’s beneficial interest wholly or partly.

According to the general principles of the law of tort, a wrongdoer shall assume legal liabilities for his/her tortious act. Thus, if the beneficiary has committed serious tort in relation to the settlor or other beneficiaries, the beneficiary shall bear the relative civil or even criminal liabilities. However, the Chinese *Law of Trusts* regards the seriously tortious act of a beneficiary committed in relation to the settlor and to other beneficiaries as reasons to empower the settlor to change the beneficiary or dispose of (revoke) the beneficiary’s beneficial interest.

In regard to the property the beneficiary has already received, this article does not clearly provide whether the revocation is retrospective or not. It is suggested that the settlor’s right to revocation should not be retrospective, because the property already received by the beneficiary has become the beneficiary’s own property and no longer the beneficial interest.

The basis of the settlor’s right of revocation is that the beneficiary has committed a serious tort either in relation to the settlor or in relation to the other co-beneficiaries. Nevertheless, the provisions of article 51 are not reasonable. On the one hand, the serious tort is an uncertain concept. It is difficult to judge what kind of tort constitutes serious tort. On the other hand, this article does not distinguish the intentional tort from the negligence. If the interest of a beneficiary is revoked because of his/her negligently tortious act, it contravenes the purpose of the trust.

The legislative reason of this article may stem from article 7 of the Chinese *Law of Succession*, which provides:

A successor shall be disinherited upon his commission of any one of the following acts:

- (1) intentional killing of the decedent;
- (2) killing any other successor in fighting over the legacy;
- (3) a serious act of abandoning or maltreating the decedent; or
- (4) a serious act of forging, tampering with or destroying the will.

According to this article, a successor can only be disinherited if he/she commits felonies, such as intentional killing of the decedent or killing any other successor in fighting over the legacy. Compared with article 7 (1) and (2) of the Chinese *Law of Succession*, it is suggested that article 51 (1) (a) and (b) of the Chinese *Law of Trusts* should be amended as that where the beneficiary commits “intentional killing or injury to the settlor” or “intentional killing or injury to other beneficiary in fighting over the trust property”, the settlor may change the beneficiary or dispose of the beneficial interest of the beneficiary.

## 4.2.2 Termination of Trusts

A trust will not be terminated by reason of the death or incapacity of the settlor or by reason of the termination of the office of the trustee after it is created, unless it is otherwise provided in the trust instrument or there arise special circumstances. Article 52 of the Chinese *Law of Trusts* provides:<sup>26</sup>

Except where it is otherwise provided by this law or by trust instrument, a trust shall not be terminated by virtue of the fact that the settlor or the trustee dies, loses legal capacity, dissolves under laws, is rescinded under laws or is declared bankrupt, nor shall it be terminated by virtue of the resignation of the trustee.

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<sup>26</sup> . See also the *Law of Trusts* of ROC, article 8.

However, a trust may be terminated by virtue of certain reasons. Under the Civil Law, the termination of trusts can be divided into two categories: the natural termination and non-natural termination. The natural termination arises where a trust is terminated because the reasons for termination provided for by the terms of the trust have happened; the purpose of the trust has been achieved; or the achievement of the purpose of the trust has become impossible. The non-natural termination of a trust mainly refers to the termination by the settlor or by the court before the purpose of the trust has been completely achieved.

#### **4.2.2.1 The termination of trusts in Japan, South Korea and Taiwan**

The legislation in Japan, South Korea and Taiwan draws a clear distinction between the natural termination and non-natural termination. The *Law of Trusts* in Japan, South Korea and Taiwan provide for the natural and non-natural termination of trusts respectively. In respect of the natural termination of a trust, article 56 of the Japanese *Law of Trusts* provides:<sup>27</sup>

When the cases specified in the act of a trust have happened, or where the purpose of the trust has been achieved or has become impossible to be achieved, the trust shall be thereby terminated.

Usually, the cases specified in the trust instrument mainly refer to the period of the trust and the conditions subsequent to the termination of the trust.

With respect to the non-natural termination of a trust, the *Law of Trusts* in these jurisdictions provide that the settlor or his/her heirs can revoke the trust at any time if

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<sup>27</sup> . See also the South Korean *Law of Trusts*, article 55; the *Law of Trusts* of ROC, article 62.

the settlor is entitled to the whole of the benefits of a trust. Article 57 of the Japanese *Law of Trusts* provides:<sup>28</sup>

In cases where the settlor is entitled to the whole of the benefits of a trust, the settlor or his or her heirs may at any time revoke the trust. In such cases, the provisions of Article 651 (2) of the Civil Code shall apply mutatis mutandis.

This article stems from article 651 of the Japanese *Civil Code* which provides for the termination of a mandate and reads as follows:

- (1) A mandate may be revoked by either party at any time.
- (2) If one of the parties revokes a mandate at a time when it would be unfavourable to the other party, he/her shall compensate for any damages occasioned thereby; however, this shall not apply when unavoidable reason exists for such revocation”.

Likewise, article 63 of the *Law of Trusts* of ROC, which also has borrowed the provisions of article 549 of the *Civil Code* of ROC, provides:

- (1) In cases where the settlor is entitled to the whole of the benefits of a trust, the settlor or his/her heirs may at any time revoke the trust
- (2) Where the settlor or his/her heirs revoke the trust in accordance with the provisions of the preceding paragraph at a time when it is prejudicial to the trustee, the settlor or his/her heirs are liable to indemnify the trustee unless the revocation has been taken place under unavoidable reasons.

Nevertheless, under a mandate contract, either party of the mandate can terminate the mandate; whereas under a trust, it is the settlor rather than the trustee who has the right to terminate it.

In the case where the settlor is entitled to the whole of the benefits of the trust, the settlor is the sole beneficiary. It may also say that a sole beneficiary is entitled to terminate the trust at any time.

However, it is difficult to understand why the settlor’s heirs have also the right to terminate the trust at any time. Where the settlor who enjoys the whole of the benefits

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<sup>28</sup> . See also the *South Korea Law of Trusts*, article 56.

of the trust dies, the trust should be terminated naturally because the death of the settlor amounts to that the trust purpose cannot be achieved. In this case, the trustee should deliver the remaining trust property (if any) to the heirs of the settlor. There is neither the question of the termination of the trust by the heirs of the settlor, nor the question of the termination of the trust by the heirs *at any time*. Where the heirs of the settlor could terminate the trust at any time, it seems that the trust would still be alive between the death of the settlor and the revocation by the heirs. Thus, to give the heirs of the settlor the right to terminate the trust after the death of the settlor is illogical.

The *Law of Trusts* in Japan and South Korea do not deal with the termination of a trust of which the settlor is not the sole beneficiary, but the *Law of Trusts* of ROC provides that such a trust may be terminated by settlor together with the beneficiary. Article 64 (1) of the *Law of Trusts* of ROC provides:

In cases where the settlor is not entitled to the whole of the benefits of a trust, the settlor and the beneficiary may at any time unanimously terminate the trust unless it is otherwise provided by the trust instrument.

Thus, so long as the settlor or the beneficiary cannot agree upon the termination of the trust, the trust shall not be terminated.

Although the *Law of Trusts* in Japan and South Korea do not provide for the beneficiary's right to revoke, the *Laws* confer on the beneficiary the right to apply to the court to revoke the trust.

Article 58 of the Japanese *Law of Trusts* provides:<sup>29</sup>

Except in the case mentioned in the preceding Article, if in cases where the beneficiary is entitled to the whole of the benefits of a trust, it is impossible to fully perform the obligation without resorting to the trust property, or there exist any other unavoidable reasons, the court may, upon application of the beneficiary or of persons interested, order revocation of the trust.

On the contrary, the *Law of Trusts* of ROC does not give the beneficiary this right.

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<sup>29</sup> . See also the South Korean *Law of Trusts*, article 57.

Where a trust is terminated, it is provided that the remainder of the trust property shall be vested in the beneficiary, in the persons designated by the trust instrument, or in the settlor or his/her heirs if there is no such designated persons in the trust instrument. Article 61 of the Japanese *Law of Trusts* provides:<sup>30</sup>

In cases where the trust has been revoked pursuant to the provisions of Article 57 or of Article 58, the trust property shall vest in the beneficiary.

Whilst article 62 of the *Law* provides:<sup>31</sup>

If, upon termination of a trust, there is no person designated in the act of trust in whom the trust property is to vest, the trust property shall vest in the settlor or his/her heirs.

With respect to vesting the trust property, article 65 of the *Law of Trusts* of ROC also provides:

Where a trust is terminated, unless it is otherwise provided by the trust act, the trust property shall be vested in the following persons in order:

- (1) the beneficiary who is entitled to the whole of the benefits;
- (2) the settlor or his/her heirs.

#### **4.2.2.2 The termination of trusts in China**

##### **4.2.2.2.1 The general provisions on the termination of trusts**

In China, like its counterparts in Japan, South Korea and Taiwan, the Chinese *Law of Trusts* also provides that a trust may be terminated naturally or be terminated by revocation of the settlor. Article 53 of the Chinese *Law of Trusts* provides:

A trust shall be terminated under any of the following circumstances:<sup>32</sup>

- (1) the causes of termination specified in the trust instrument have occurred;

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<sup>30</sup> . Ibid, article 59.

<sup>31</sup> . Ibid, article 60.

<sup>32</sup> . Rescinding a trust which is provided for by article 53 (5) is different from revoking a trust which is provided for by article 53 (6). Rescission of a trust is provided for by article 12 of the Chinese *Law of Trusts*. It means that a trust is rescinded by the court on the application of the creditors of the settlor if the trust is prejudicial to the creditors of the settlor. Revocation of a trust is provided for by article 50 and article 51 of the Chinese *Law of Trusts*. It means a trust is terminated by the settlor for certain reasons. See also the following section, 4.2.2.2.2 “Several problems relating to the termination of trusts in China”, of this thesis.

- (2) the continued existence of the trust shall violate the purpose of the trust;
- (3) the aim of the trust has been achieved or has become impossible to be achieved;
- (4) the parties to the trust agree to terminate the trust;
- (5) the trust has been rescinded;
- (6) the trust has been revoked.

In respect of the revocation of the trust by the settlor, the Chinese *Law of Trusts* provides that the settlor is entitled to revoke a trust by himself/herself if he/she is the sole beneficiary of the trust, or to revoke a trust with the consent of the beneficiary if he/she is not the sole beneficiary or not one of the beneficiaries. Unlike the *Law of Trusts* of Japan, South Korea and Taiwan which use the phrase “the settlor is entitled to the whole of the benefits of a trust”,<sup>33</sup> article 50 of the Chinese *Law of Trusts* adopts the phrase “a settlor is the sole beneficiary” used in section 399 of the *American Restatement of Trusts 2d* which provides:

Where a settlor is the sole beneficiary, he/she or his/her heir may revoke the trust; where it is otherwise provided by the trust instrument, such provisions shall prevail.

Where the settlor is not the sole beneficiary, according to article 51 of the *Law*, the settlor is entitled to vary or revoke the trust under the following three circumstances: “where the beneficiary has committed a serious tort in relation to the settlor”;<sup>34</sup> “where the beneficiary agrees with the revocation of the settlor”;<sup>35</sup> “where there exist other circumstances specified in the trust instrument”.<sup>36</sup>

In addition, the Chinese *Law of Trusts* also provides that the disclaimer of beneficial interest by the beneficiary will result in the termination of a trust. Article 46 of the Chinese *Law of Trusts* provides:

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<sup>33</sup> . The Japanese *Law of Trusts*, article 57; the South Korean *Law of Trusts*, article 56; and the *Law of Trusts* of ROC, article (1).

<sup>34</sup> . The Chinese *Law of Trusts*, article 51 (1) (a) and (2).

<sup>35</sup> . Ibid, article 51 (1) (c) and (2).

<sup>36</sup> . Ibid, article 51 (1) (d) and (2).

- (1) The beneficiary may disclaim his/her right to the beneficial interests.<sup>37</sup>
- (2) Where all the beneficiaries disclaim their rights to the beneficial interests, the trust is terminated.<sup>38</sup>
- (3) Where some of beneficiaries disclaim their rights to the beneficial interests, these disclaimed interests shall be enjoyed by the persons in accordance with the following order:
  - (a) the person who designated in the trust instrument;
  - (b) other beneficiaries;
  - (c) the settlor or his/her heir.

In respect of how to deal with the trust property after a trust is terminated, article 54 of the Chinese *Law of Trusts* provides:

Upon the termination of a trust, the trust property shall vest in the person designated in the trust instrument; where there is no such designation in the trust instrument, the trust property shall vest in these persons in accordance with the following order:

- (1) the beneficiary or his/her heir;
- (2) the settlor or his/her heir.

#### **4.2.2.2.2 Several problems relating to the termination of trusts in**

#### **China**

Looking at articles 50, 51, 53 and 54 of the Chinese *Law of Trusts*, there are three questions which need to be examined. First, it is not accurate for article 53 (5) of the Chinese *Law of Trusts* to list the rescission of a trust as a method of terminating trusts. Like the *Law of Trusts* of Japan, South Korea and Taiwan,<sup>39</sup> the whole Chinese *Law of Trusts* only provides for one circumstance under which a trust may be rescinded by the court on the application of the creditors of the settlor. Article 12 (1) of the Chinese *Law of Trusts* provides that “where a settlor/testator has created a trust which is to be

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<sup>37</sup> . See also the South Korean *Law of Trusts*, article 51 (3); the *Law of Trusts* of ROC, article 17 (2).

<sup>38</sup> . The Chinese *Law of Trusts*, article 46 (2).

<sup>39</sup> . The Japanese *Law of Trusts*, article 12; the South Korean *Law of Trusts*, article 8; the *Law of Trusts* of ROC, article 6.

prejudicial to the interests of his/her creditor, the creditor is entitled to apply to the court to rescind the trust”. According to the basic principle of the civil law, a void or rescinded juristic act is deemed to take void *ab initio*. Article 59 (2) of the Chinese GPCL provides that “a rescinded civil juristic act shall be deemed to have been void *ab initio*”.<sup>40</sup> Although article 12 (2) of the Chinese *Law of Trusts* provides that “the rescission made by the court pursuant to the provisions of the preceding paragraph of this Article shall not affect the benefits which a bona fide beneficiary has already received”, it is an exceptional provision stipulated by the special law to the basic civil law principle. Thus, a trust which is rescinded by reason of prejudicing the creditors of the creator should be deemed as having not been created from the very beginning.

Since a rescinded trust is void *ab initio*, the “trust property” should be the creator’s own property and the trustee should return the property to the creator or his/her heirs of the rescinded trust. Thus, article 54 of the Chinese *Law of Trusts* shall not apply to a rescinded trust. It is suggested that article 53 (5) of the *Law* should be deleted.

Secondly, the provisions of article 51 of the Chinese *Law of Trusts* for the revocation of a trust by the settlor are not reasonable. With respect to the revocation of a trust under the cases of (a), (c) and (d) of article 51 (1) of the Chinese *Law of Trusts*, as it is suggested above, the term “serious tort” should be modified and the intentional tort should be distinguished from the tort with negligence. In the case where the beneficiary agrees with the settlor to revoke the trust, it is suggested that two matters should be considered. One is that the reimbursement of the trustee who runs trusts as its business should be considered. Although the trust *inter vivos* is created by the trust contract between the settlor and the trustee, the avoidance of the trust is also governed by the *Law of Contract*. The trustee will not be fundamentally

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<sup>40</sup> . See also the Japanese *Civil Code*, article 121; the *Civil Code* of ROC, article 114.

affected by the avoidance because he/she cannot benefit from the trust property. Thus if the trustee runs the trusteeship as a business and has accepted the trust for remuneration, the settlor and the trustee should come to terms with the remuneration of the trustee before the settlor set aside the trust, or the trustee can detain the trust property for reimbursement.

The other matter that should be considered is the benefits which the beneficiary have already received. A trust is created for the benefits of the beneficiary, so the benefits the beneficiary has received before he/she consents the settlor to set aside the trust should not be affected by the avoidance of the trust. Even if the beneficiary agrees to return the benefits he/she has received to the settlor, it should be regarded legally as a new gift rather than the return of the trust property.

Thirdly, the conferment of the right to terminate a trust on the settlor rather than the beneficiary is not convincing and not available to protect the beneficiary. Like the *Law of Trusts* in Japan, South Korea and Taiwan, the Chinese *Law of Trusts* confers on the settlor, not on the beneficiary, the right to terminate the trust. The ultimate purpose of a trust is to make the beneficiary enjoy the beneficial interest and the trustee administers the trust affairs for the benefits of the beneficiary rather than the benefits of the settlor. Thus, the ultimate right to decide the termination of the trust should be conferred on the beneficiary, like the rule established in *Saunders v Vautier*<sup>41</sup> under the Common Law. If the settlor wants to reserve the right to terminate the trust, he/she can insert a term into the trust instrument to reserve such a right.

To prevent the beneficiary from terminating the trust while conferring the right to set aside the trust on the settlor is not in accord with the interest of the beneficiary and the purpose of the trust. In addition, the termination of trusts is also limited greatly, especially in the case of testamentary trusts. Because the settlor's right to terminate

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<sup>41</sup> . (1841) 4 Beav 115; 49 ER 282.

can only apply to the trust *inter vivos*, the only circumstance under which a testamentary trust can be terminated is that the trustee and the beneficiary both agree upon to terminate it in compliance with article 53 (4) of the Chinese *Law of Trusts*.

Therefore, it is suggested that the Chinese *Law of Trusts* should confer on the beneficiaries the right to terminate the trust so long as they are absolutely entitled to the trust property, are under no legal disability and unanimously consent to terminate the trust. Meanwhile, the Chinese *Law of Trusts* should also empower the court to vary or terminate the trust partly or wholly on the application of the trust parties.

# Chapter 5

## Charitable Trusts

### 5.1 The Nature of Charitable Trusts

#### 5.1.1 Definition of Charitable Trusts

The law of charitable trusts is a very important part of trusts law under both the Common Law and the Civil Law jurisdictions. Although, as discussed at the beginning of this thesis, it is very difficult to define a trust, it is easy to define a charitable trust. A charitable trust can be simply defined as a trust created for a charitable purpose or for charitable purposes. Section 348 of the *Restatement of Trusts 2d* provides:

A charitable trust is a fiduciary relationship with respect to property arising as a result of a manifestation of an intention to create it, and subjecting the person by whom the property is held to equitable duties to deal with the property for a charitable purpose.

Article 66 of the Japanese *Law of Trusts* defines a charitable trust as follows: “Any trust, the object of which consists in veneration, religion, charity, science, the arts, and other public benefits, shall be charitable trusts”.<sup>1</sup>

However, before discussing charitable trusts, it is noteworthy that the designation of charitable trusts under the Common Law jurisdictions is different from that under China, Japan, South Korea and Taiwan. Under these Civil Law jurisdictions, “charitable trusts” are called “public benefit trusts” rather than “charitable trusts” under the Common Law jurisdictions.

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<sup>1</sup>. See also: the South Korean *Law of Trusts*, article 65; the *Law of Trusts* of ROC, article 69.

The term “public benefit” in the above Civil Law jurisdictions means “公益(*gong yi*)” in Chinese. It refers to any thing or any act beneficial to the public or a section of public, or beneficial to the community. However, the term “charity” means “慈善(*ci shan*)” in Chinese. The concept of charity merely means benevolence. It refers narrowly to kindness or generosity, or it refers to any kind or generous act to help poor people or people in need of assistance by giving them money or other property. Furthermore, charitable acts may or may not possess public characteristics. In many cases, charitable acts do not contain public benefit. For example, giving one dollar to a beggar is a charitable act, but it is not an act beneficial to the public. Although a trust is created for the purpose of charity, it cannot constitute a public benefit trust if the charitable purpose is not also beneficial to the public. Only those trusts which are created for the benefit of the public can be regarded as “public benefit trusts”.

Therefore, in the light of article 66 of the Japanese *Law of Trusts*, article 65 of the *Law of Trusts* of South Korea, and article 69 of the *Law of Trusts* of ROC, charitable trusts which are also beneficial to the public are merely one type of public benefit trusts.

On the contrary, under the Common Law jurisdictions, the trusts for the purpose or purposes beneficial to the public are regarded as one category of charitable trusts. It is noteworthy that there are some public benefit trusts that are not charitable trusts.<sup>2</sup> In addition, not all the charitable trusts are required to satisfy the requirement of public benefit under the Common Law. In Australia and England, the trusts for the relief of poverty, namely the “poor relations” cases, are charitable trusts at law. However, in

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<sup>2</sup>. *The Royal National Agricultural and Industrial Association v Chester* (1974) 48 ALJR 304.

the United States, the trusts for the relief of poverty are also required to be beneficial to the public.<sup>3</sup>

The Chinese *Law of Trusts* also adopts the same term, “public benefit trusts”, to designate charitable trusts, but it does not follow the *Law of Trusts* in Japan, South Korea and Taiwan which provide that charitable trusts are one category of public benefit trusts. Since charity means to help the poor people, or to help the people in necessitous circumstances, article 60 of the Chinese *Law of Trusts* ingeniously avoids the possible confusion between a charitable trust and a public benefit trust simply by providing directly for the trusts for the relief of poverty, the relief of victims of natural calamities, and the assistance of the disabled in lieu of providing for the category of trusts for the purposes of charity.

For the sake of convenience, the “public benefit trusts” under the Civil Law jurisdictions are still designated as “charitable trusts” in this thesis. Thus, the term “charitable trusts” refers to both the “public benefit trusts” under the Civil Law jurisdictions and the “charitable trusts” under the Common Law jurisdictions

## **5.1.2 Distinction between Charitable Trusts and Other Express Trusts**

Although charitable trusts are created for the promotion of charitable purposes, they are, in their nature, express trusts, and many of the rules applicable to private trusts are also applied to charitable trusts. However, charitable trusts, as express public trusts, are distinct from private express trusts. Some rules applicable to charitable trusts are not applicable to private trusts, while some rules applicable to private trusts are not applied to charitable trusts.

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<sup>3</sup>. See comment “g” on section 369 of the *Restatement of Trusts 2d* and *Stanton v Stanton*, 140 Conn. 504; *Hardage v Hardage*, 211 Ga 80; *Kent v Dunham*, 142 Mass. 216.

The fundamental distinction between a charitable trust and a private express trust lies in their different purposes. In *Attorney-General for New South Wales v Perpetual Trustee Company (Limited)*,<sup>4</sup> Dixon and Evatt JJ enunciated:<sup>5</sup>

A charitable trust is a trust for a purpose, not for a person. The objects of ordinary trusts are individuals, either named or answering a description, whether presently or at some future time. To dispose of property for the fulfilment of ends considered beneficial to the community is an entirely different thing from creating equitable estates and interests and limiting them to beneficiaries. In this fundamental distinction sufficient reason may be found for many of the differences in treatment of charitable and ordinary trusts.

The definitions of the charitable trusts and other express private trusts given by the *Law of Trusts* under the Civil Law jurisdictions actually explain such a distinction. Accordingly, the purpose of creating a charitable trust is to benefit the public or a section of public, while an express trust other than a charitable trust is created to benefit a person or persons.

Since charitable trusts are created for charitable purposes rather than for persons, the distinction directly results in that the certainty of objects, which is required for creating a private trust, is not available to a charitable trust.

Also, a charitable trust may exist for an indefinite period, so the rule against perpetuities is not applicable to charitable trusts under the Common Law. However, it is noteworthy that although the period of a charitable trust may last indefinitely, the property intended to be vested for the fulfilment of the purpose of the charitable trust must still be vested in the trustee within the perpetuity period. Because there are no provisions for the rule against perpetuities under the Civil Law, either a charitable trust or a private express trust may exist beyond the perpetuity period prescribed by trusts law under the Common Law jurisdictions.

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<sup>4</sup> . (1940) 63 CLR 209.

<sup>5</sup> . Ibid, at 222.

Again, because charitable trusts are created for achieving charitable purposes, the creation of charitable trusts is encouraged under both the Common Law and the Civil Law jurisdictions. Article 61 of the Chinese *Law of Trusts* expressly provides “the State encourages the development of charitable trusts”. The most important method of encouragement may be the exemption of trust properties from income tax or other taxes. For example, section 505 of the *Income and Corporation Taxes Act 1988* (UK) provides that the income of trusts created for charitable purposes only can be generally exempt from income tax. Sections 50-1 and 50-5 of the Australian *Income Tax Assessment Act 1997* provide that the ordinary income or the statutory income of the “fund established in Australia for public charitable purposes by will or instrument of trust” is exempt.

Article 11 (3) of the Japanese *Income Tax Law* also provides: “The income tax shall not be imposed on the income accrued to the trust property of the said charitable trust provided for in article 66 (Charitable Trusts) of the Trusts Law (Law No. 62 of 1922)”. Although the income tax law of China does not provide for the property of charitable trusts can be exempt from income tax, according to article 24, 25, and 26 of the Chinese *Law of Charitable Donations*, the properties donated for charitable purposes enjoy the preferences from income tax, import tax, and surplus tax which are levied on companies and individuals.

Unlike the Common Law jurisdiction, under which the creation of charitable trusts is almost the same as the creation of private trusts, the creation of charitable trusts under the Civil Law jurisdiction is more stringent than the creation of private trusts. In Japan and South Korea, the trustee must obtain the permission from the competent government office before accepting a charitable trust. Article 68 of the Japanese *Law of Trusts* provides that “in order to accept a charitable trust, the trustee shall obtain

permission of the competent government office”.<sup>6</sup> In China and Taiwan, both the creation of the charitable trusts and the trustee shall be approved by the administrative office of charitable business. Article 62 of the Chinese *Law of Trusts* provides that “the creation of a charitable trust and the trustee shall be approved by the administrative office of charitable business”<sup>7</sup> and “without the approval of the administrative office, no one can conduct activities in the name of charitable trust”.

In addition, the supervision, the variation of a charitable trust, and the resignation of the trustee of a charitable trust differ from that of a private trust under the Civil Law jurisdictions. The competent government office or the administrative office is usually empowered to supervise the trust, to vary the trust, and to approve the resignation of the trustee. Article 67 of the Japanese *Law of Trusts* expressly provides: “Charitable trusts shall be subject to the supervision by the competent government office”.<sup>8</sup> The competent government office “may at any time inspect the management of affairs of a charitable trust”.<sup>9</sup>

In respect of the variation of trusts, the competent government office or administrative office is empowered to vary charitable trusts in certain circumstances. Article 69 of the Chinese *Law of Trusts* provides: “After the creation of a charitable trust, the administrative office may vary the terms of the trust in accordance with the tenor of the trust if special circumstances which would not have been foreseen at the time of the creation arise”.<sup>10</sup>

All the *Laws of Trusts* under the Civil Law jurisdictions provide for the stringent requirement for the trustee to resign from his/her office. Article 66 of the Chinese

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<sup>6</sup> . See also the South Korean *Law of Trusts*, article 66.

<sup>7</sup> . See also the *Law of Trusts* of ROC, article 70.

<sup>8</sup> . The South Korean *Law of Trusts*, article 69; the *Law of Trusts* of ROC, article 72 (1).

<sup>9</sup> . The Japanese *Law of Trusts*, article 69. See also the Chinese *Law of Trusts*, article 67; the South Korean *Law of Trusts*, article 70; the *Law of Trusts* of ROC, article 72 (2) and (3).

<sup>10</sup> . See also the Japanese *Law of Trusts*, article 70; the South Korean *Law of Trusts*, article 67; the *Law of Trusts* of ROC, article 73.

*Law of Trusts* provides: “The trustee of a charitable trust cannot resign from his/her office without the permission of the administrative office”.<sup>11</sup> Similarly, article 71 of the Japanese *Law of Trusts* provides: “The trustee of a charitable trust may resign from his office upon permission being granted by the competent government office, only in cases where there exist unavoidable reasons”.<sup>12</sup> In addition, the trusts law of the Civil Law jurisdictions also provides that the competent government office or the administrative office is entitled to replace a trustee of a charitable trust if the trustee act in breach of his/her duty or is unable to perform his/her duty.<sup>13</sup>

The application of the cy-pres doctrine is another distinction between charitable trusts and private trusts. Both the law of trusts of the Common Law and the Civil Law jurisdictions provide that where the original charitable purpose of a charitable trust is or becomes impossible to be achieved, or has been achieved without exhausting the trust property, the trust property or the surplus can be applied to other similar charitable purposes by applying the cy-pres doctrine.

Moreover, the enforcement of a charitable trust is different from that of a private trust. Under the Civil Law jurisdictions, although the trust administrator or curator is entitled to bring into any actions relating to a charitable trust in and out of the court in his/her own name, the right to enforce the charitable trust is conferred on the competent government office or the administration office set up for supervising the charitable trust. Similarly, under the Common Law jurisdictions, the power of enforcement of the charitable trusts is conferred on the Attorney-General.

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<sup>11</sup> . See also the *Law of Trusts* of ROC, article 74.

<sup>12</sup> . See also the South Korean *Law of Trusts*, article 68.

<sup>13</sup> . The Chinese *Law of Trusts*, article 68; the Japanese *Law of Trusts*, article 72; the South Korean *Law of Trusts*, article 71; the *Law of Trusts* of ROC, article 76.

It is clear that all the distinctions between a charitable trust and a private express trust derive from the different purposes of the two kinds of trusts. Thus, to clarify the purposes of charitable trusts is the first objective.

## **5.2. Charitable Purposes**

### **5.2.1 Charitable Purposes under the Common Law**

#### ***5.2.1.1 The Charitable purposes Enumerated in the Preamble to the Statute of Charitable Uses 1601 (Eng)***

The term “charity” has a broad sense. It, “in absence of legislative definition, is [an] attempt in good faith, spiritually, physically, intellectually, socially and economically to advance and benefit mankind in general, or those in need of advancement and benefit in particular, without regard to their ability to supply that need from other sources and without hope or profit by donor or by instrumentality of charity”.<sup>14</sup> However, in the law of trusts, the term “charity” has a special meaning and not all types of public benevolence are regarded as charitable. The denotation of charity in the law of trusts derives from the charitable purposes enumerated in the Preamble to the *Statute of Charitable Uses* 1601 (England),<sup>15</sup> which is also called *Statute of Elizabeth*. The *Statute* was not enacted for the purpose to define the meaning of charity in the law of trusts, but enacted for the purpose “merely to provide new machinery for the reformation of abuses in regard to charities”.<sup>16</sup> The charitable purposes enumerated by Preamble to the *Statute of Charitable Uses* 1601 (England) are as follows:

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<sup>14</sup> . *Black’s Law Dictionary* (1979, fifth edition), p 213.

<sup>15</sup> . 43 Eliz 1 c 4.

<sup>16</sup> . *Commissioners for Special Purposes of the Income Tax v Pemsel* [1891] AC 531 at 581 (per Lord Macnaghten).

... some for relief of aged, impotent and poor people, some for maintenance of sick and maimed soldiers and mariners, schools of learning, free schools and scholars in universities, some for repair of bridges, ports, havens, causeways, churches, sea-banks and highways, some for education and preferment of orphans, some for or towards relief stock or maintenance for houses of correction, some for marriages of poor maids, some for supportation, aid and help of young tradesmen, handicraftsmen and persons decayed, and others for relief or redemption of prisoners or captives, and for aid or ease of any poor inhabitants concerning payment of fifteens, setting out of soldiers and other taxes...

The Preamble provided a distinction between the legal meaning of charity and the broad non-legal meaning of charity. In *Verge v Somerville*,<sup>17</sup> Lord Wrenbury stated:<sup>18</sup>

In the investigation of the legal meaning of the word “charity” as distinguished from its popular meaning, the statute of Elizabeth (43 Eliz, ch 4) must always be the starting point.

... In fact, the legal meaning and the popular meaning of the word “charity” are so far apart that it is necessary almost to dismiss the popular meaning from the mind as misleading before setting out to determine whether a gift is charitable within the legal meaning.

Although the Preamble to the *Statute* listed detailed charitable purposes, undoubtedly, it did not and could not exhaust all the charitable purposes. However, the Preamble provided guidance for identifying a charitable purpose in the legal sense of the term. The starting point in determining whether a trust is created for a charitable purpose is to ask whether the purpose of the trust falls within the spirit and intendment of the Preamble to the *Statute of Charitable Uses* 1601 (England), either by way of analogy with the original purposes or as directly perceived.

### **5.2.1.2 The modern four categories of charitable purposes**

Because it is practically inconvenient to describe all the charitable purposes listed in the Preamble, the charitable purposes were developed and classified into four

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<sup>17</sup> . [1924] AC 496.

<sup>18</sup> . Ibid, at 502.

categories by Lord Macnaghten in *Commissioners for Special Purposes of the Income Tax v Pemsel*,<sup>19</sup> where his Lordship stated:<sup>20</sup>

“Charity” in its legal sense comprises four principal divisions: trusts for the relief of poverty; trusts for the advancement of education; trusts for the advancement of religion; and trusts for other purposes beneficial to the community, not falling under any of the preceding heads. The trust last referred to are not the less charitable in the eye of the law, because incidentally they benefit the rich as well as the poor, as indeed, every charity that deserves the name must do either directly or indirectly...

The four categories of charitable purposes, namely the relief of poverty, the advancement of education, the advancement of religion, and the other purposes beneficial to the community, are not only the simple generalization of the charitable purposes enumerated in the Preamble, but also are the portrayal of the spirit of the Preamble. Thus, the four categories of charitable purposes fall within the spirit and intendment of the Preamble.

Unlike other Common Law countries, the United States of America adopts different categories of charitable purposes. In the light of the *Restatement of Trusts 2d*, the charitable purposes are classified as the follows: the relief of poverty; the advancement of education; the advancement of religion; the promotion of health; the promotion of governmental or municipal purposes; and the promotion of other purposes beneficial to the community.<sup>21</sup>

### **5.2.1.3 The essence of a charitable purpose**

No matter into how many categories the charitable purposes are classified, a charitable purpose must satisfy two requirements: being beneficial to the community or of public benefit, namely being beneficial to the public or a section of the public,

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<sup>19</sup> . [1891] AC 531.

<sup>20</sup> . Ibid, at 583.

<sup>21</sup> . The *Restatement of Trusts 2d*, § 369 - § 374.

and falling within the spirit and intendment of the Preamble to the *Statute of Charitable Uses* 1601 (England).

In *Commissioners for Special Purposes of Income Tax v Pemsel*,<sup>22</sup> Lord Macnaghten emphasized that not only the last category but all the four categories of charitable trusts shall be directly or indirectly beneficial to the community, by saying “every charity that deserves the name must do either directly or indirectly”.<sup>23</sup>

In *Williams Trustees v Inland Revenue Commissioners*,<sup>24</sup> Lord Simonds also stated:<sup>25</sup>

It is not expressly stated in the preamble to the statute, but it was established in the Court of Chancery, and, so far as I am aware, the principle has been consistently maintained, that a trust in order to be charitable must be of a public character. It must not be merely for the benefit of particular private individuals: if it is, it will not be in law a charity though the benefit taken by those individuals is of the very character stated in the preamble...

Both the fourth category of charitable purposes outlined by Lord Macnaghten and the category of charitable purposes provided for by section 374 of the *Restatement of Trusts 2d* are named clearly as the charitable purposes beneficial to the community. However, it is not enough for a charitable purpose to be merely beneficial to the community. It should also satisfy the second requirement. Namely, it must fall within the spirit and intendment of the Preamble to the *Statute of Charitable Uses* 1601 (Eng). In an earlier case, *Morice v Bishop of Durham*,<sup>26</sup> the Master of Rolls, Sir William Grant declared that the signification of charity was derived mainly from the Preamble to the *Statute of Charitable Uses* 1601 (Eng) or by analogies to the purposes enumerated in the Preamble.<sup>27</sup>

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<sup>22</sup> . [1891] AC 531.

<sup>23</sup> . Ibid, at 583.

<sup>24</sup> . [1947] AC 447.

<sup>25</sup> . Ibid, at 457.

<sup>26</sup> . (1804) 9 Ves 399; 32 ER 656.

<sup>27</sup> . Ibid at 405; at 658 – 659 respectively.

In *Royal National Agricultural and Industrial Association v Chester*,<sup>28</sup> the High Court of Australia, in a joint judgement, held that to be charitable a purpose must be both beneficial to the community and within the spirit and intendment of the Preamble of the *Statute*.<sup>29</sup> In giving its reasoning, the court held:<sup>30</sup>

To justify an affirmative answer, it seems to us that it must, at least, be found that the breeding or racing pigeons is a purpose both beneficial to the community and within the spirit and intendment of the preamble to the statute 43 Eliz. 1. 4. The House of Lords' decisions in *Williams's Trustees v Inland Revenue Commissioners* [1947] AC 477, and *Scottish Burial Reform and Cremation Society v Glasgow Corp* [1968] AC 138, provide modern authority that the existence of these two elements is both necessary and sufficient to warrant the conclusion that a particular purpose is charitable in law. This court so decided in *Incorporated Council of Law Reporting (Q) v Federal Commissioner of Taxation* (1971) 125 CLR 659, at 667 and 669 per Barwick CJ.

Thus, the High Court held that although the breeding of pigeons for racing may be a purpose beneficial to the community, may provide recreation for quite a number of pigeon fanciers, may produce birds which are interesting, beautiful, may at times be useful as a means of communication and may afford opportunity for the scientific study of the birds' remarkable homing instinct, the gift failed because the court found "no justification for deciding that the breeding of racing pigeons is a purpose of the kind instanced in the preamble of the statute".<sup>31</sup>

### **5.2.1.3.1 The meaning of the public or a section of public**

The most important feature of a charitable trust is its public character, so the courts must decide first whether the purpose of a trust is or is not beneficial to the

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<sup>28</sup> . (1974) 48 ALJR 304.

<sup>29</sup> . Ibid, at 304 (In regard to the joint judgement, it seems there is a printing mistake, because at 304, the judges are named as McTiernan, Menzies and Mason, while at 305, the judges are named as Barwick CJ, Menzies and Mason JJ.).

<sup>30</sup> . Ibid, at 305.

<sup>31</sup> . Ibid, at 305.

public. However, it is difficult to define the public or a section of the public. It is obvious that the meaning of the public cannot merely depend on the number of people in that there may be an enormous number of beneficiaries and the trust may not be of benefit to the public, while the class of people may be small and the trust can still be charitable.

In Australia, the public was well defined in *Re Income Tax Acts (No 1)*<sup>32</sup> by Lowe J in the following elaborate exposition:<sup>33</sup>

It may not be easy or even possible to enumerate in advance the *differentiae* of a “section of the public” within this rule, but I illustrate along what lines a conclusion may be arrived at. Having regard to the composition of the public, certain large groups may readily be recognised, the members of which have a common calling or adhere to a particular faith or reside in a particular geographical area. There is no bar which admits some members of the public to those groups and rejects others. Any member of the public may, if he will, follow a particular calling, adhere to a particular faith, or reside within a particular area. Of the members of such a group it may be said in a real sense that they are primarily members of the public, and such a group may well constitute a section of the public. They stand on one side of the line. Each group, it is true, may consist of many individuals, but number alone is not the criterion by which to determine whether the group constitutes a section of the public. A club, a literary society, a trade union may all have numerous members, but I think that none of these could properly be called a section of the public. They stand on the other side of the line. The distinguishing feature of each of these latter bodies is that it is an association which takes power to itself to admit or exclude members of the public according to some arbitrary test which it sets up in its rules or otherwise. Each of them does oppose a bar to admission within it. It is not one of the groups into which the community as a matter of necessary organisation of by convention is divided, but it is in a sense an artificial entity which exists for the benefit of its members as members thereof and not as members of the public.

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<sup>32</sup> . [1930] VLR 211.

<sup>33</sup> . Ibid, at 222 – 223.

This passage was wholly cited with approval by Dixon CJ in *Thompson v Federal Commissioner of Taxation*.<sup>34</sup> In that case it was held that the purported trust for bequeathing the residual estate to William Thompson Masonic School which attended by the children of the brethren and deceased brethren of the Masonic Order in New South Wales was not a charitable trust, because the Masonic Order was a voluntary association of private members into which members were admitted by the election made by the existing members and could not constitute a section of public.<sup>35</sup>

In *Oppenheim v Tobacco Securities Trust Co Ltd*,<sup>36</sup> an attempt was made to set up a trust of income to provide for the education of a group of children of employees or former employees of a group of companies. In that case, the English Court of Appeal approved the decision in *Re Compton*<sup>37</sup> and held that although this class of beneficiaries was enormous, it did not constitute a section of the public because they were identified by reference to a group of employees and a group of employees or companies would simply be a group of individual persons. Lord Simonds there held that a group of persons could not comprise a section of the community if the nexus between them was their personal relationship to an individual or individuals, by saying:<sup>38</sup>

These words “section of the community” have no special sanctity, but they conveniently indicate first, that the possible (I emphasize the word “possible”) beneficiaries must not be numerically negligible, and secondly, that the quality which distinguishes them from other members of the community, so that they form by themselves a section of it, must be a quality which does not depend on their relationship to a particular individual... A group of persons may be numerous but, if the nexus between them is their personal relationship to a single

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<sup>34</sup> . (1959) 102 CLR 315 at 323.

<sup>35</sup> . Ibid, at 322.

<sup>36</sup> . [1951] AC 297.

<sup>37</sup> . [1945] Ch 123.

<sup>38</sup> . *Oppenheim v Tobacco Securities Trust Co Ltd* [1951] AC 297 at 306.

propositus or to several propositi, they are neither the community nor a section of the community for charitable purposes.

The “personal nexus” test proposed by Lord Simonds was also accepted by the Privy Council in *Davies v Perpetual Trustee Company Limited*.<sup>39</sup> In that case, a trust was purportedly created to establish a college for the education of the youth of Presbyterians who were descendants of Presbyterians who had settled in New South Wales from the North of Ireland. It was held that although object of the testator’s bounty was *prima facie* a charitable object, being concerned both with education and with the advancement of a particular religious faith, the qualifications for eligibility for education at the proposed college had the result of making beneficiaries under the trust nothing more than “a fluctuating body of private individuals”, and the gift failed because the necessary element of public benefit was lacking.<sup>40</sup>

Although their Lordships in that case adopted the “personal nexus” test, it seemed that the reasoning which simply denied the Presbyterian youth was a section of public was not convincing. It seemed more likely that their Lordships made their decision on the footing of preventing discrimination between different sections of the descendants of Presbyterians. Their Lordships there stated that:

It cannot be said that boys whose Presbyterian ancestors (living on January 21, 1897) trace their descent from emigrants from Northern Ireland are in greater need of education in the standards of the Westminster Divines than other boys whose Presbyterian ancestors (living as aforesaid) are descended from emigrants from, e.g., England or Scotland.

### **5.2.1.3.2 The exception to the requirement of public benefit**

Although Lord Macnaghten emphasized, in *Commissioners for Special Purposes of Income Tax v Pemsel*,<sup>41</sup> that every charity that *deserves the name* must be

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<sup>39</sup> . [1959] AC 439.

<sup>40</sup> . Ibid, at 439.

<sup>41</sup> . [1891] AC 531 at 583.

beneficial to the community either directly or indirectly, and although, in *Re Compton*<sup>42</sup> and in *Oppenheim v Tobacco Securities Trust Company Ltd*,<sup>43</sup> the principle which requires being charitable the purposes of trusts should be of public benefit, there is exception to the general rule. The requirement of public benefit is not applicable to all the four categories of the charitable trusts.

The major exception to this public benefit requirement is the first category of charitable trusts, namely the trusts for the relief of poverty. So long as a trust is created for the relief of poverty, it does not need to satisfy the requirement of public benefit.

In *In re Scarisbrick*,<sup>44</sup> it was held that there was an exception to the general rule that a trust or gift in order to be charitable in the legal sense must be for the benefit of the public or a section of the public, accordingly, one half of the residuary estate of the testatrix was held upon valid charitable trusts for distribution among poor members of the class of relations of the testatrix's three children. In that case, Jenkins LJ first listed the general rule of the requirement of public benefit for charitable trusts, and then his Lordship said:<sup>45</sup>

There is, however, an exception to the general rule, in that trusts or gifts for the relief of poverty have been held to be charitable even though they are limited in their application to some aggregate of individuals ascertained as above, and are therefore not trusts or gifts for the benefit of the public or a section thereof.

The decision in *In re Scarisbrick*<sup>46</sup> was approved by the House of Lords in *Dingle v Turner*.<sup>47</sup> In that case, the trustees were directed to apply the income of an invested fund to pay pensions to poor employees of a company. It was held that a trust for poor

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<sup>42</sup> . [1945] Ch 123.

<sup>43</sup> . [1951] Ac 297.

<sup>44</sup> . [1951] 1 Ch 622.

<sup>45</sup> . Ibid, at 649.

<sup>46</sup> . [1951] Ch 622.

<sup>47</sup> . [1972] AC 601.

employees was a valid charitable trust and that in the field of trusts for the relief of poverty, there was no application of the rule established in *In Re Compton*.<sup>48</sup>

In *Dingle v Turner*,<sup>49</sup> Lord Cross of Chelsea stated:<sup>50</sup>

So as it seems to me it must be accepted that wherever else it may hold sway, the *Compton* rule has no application in the field of trusts for the relief of poverty and that there the dividing line between a charitable trust and a private trust lies where the Court of Appeal drew it in *In re Scarisbrick's Will Trusts* [1951] Ch. 622.

The dividing line to distinguish a charitable trust for the relief of poverty from a private trust was declared by Jenkins LJ as follows:<sup>51</sup>

I think the true question in each case has really been whether the gift was for the relief of poverty amongst a class of persons, or rather, as Sir William Grant, M. R., put it, a particular description of poor, or was merely a gift to individuals, albeit with relief of poverty amongst those individuals as the motive of the gift, or with a selective preference for the poor or poorest amongst those individuals.

It is suggested that there are two objections to upholding a trust lacking public benefit as valid charitable trust. First, since a charitable trust is a public trust, it should be of substantial public benefit as Lord Macnaghten propounded that “every charity deserves the name must do (to benefit the community) either directly or indirectly”.<sup>52</sup> The decisions in *In re Scarisbrick*<sup>53</sup> and in *Dingle v Turner*<sup>54</sup> are really contrary to the tenor of charity. Their Lordships in those two cases should not have upheld and extended the anomalous “poor relations” cases.

Secondly, it is very difficult to distinguish a charitable trust for the relief of poverty from a private trust for the relief of poverty. In *Dingle v Turner*,<sup>55</sup> Lord Cross

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<sup>48</sup> . [1945] Ch 123.

<sup>49</sup> . [1972] AC 601.

<sup>50</sup> . Ibid, at 623.

<sup>51</sup> . *In re Scarisbrick* [1951] Ch 622 at 655.

<sup>52</sup> . *Commissioners for Special Purposes of the Income Tax v Pemsel* [1891] AC 531.

<sup>53</sup> . [1951] 1 Ch 622.

<sup>54</sup> . [1972] AC 601.

<sup>55</sup> . Ibid.

accepted Jenkins LJ's view in *In re Scarisbrick*<sup>56</sup> and held that<sup>57</sup> in the field of trusts for the relief of poverty,

[T]he distinction between a public or charitable trust and a private trust depended on whether as a matter of construction the gift was for the relief of poverty amongst a particular description of poor people or was merely a gift to particular poor persons, the relief of poverty among them being the motive of the gift.

“A particular description of poor people” is, in Jenkins LJ's words, “a class of persons”, while “particular poor persons” are, in Jenkins LJ's words, individuals. However, Jenkins LJ thought that if a class of persons was “a narrow class of near relatives, as for example to such of a testator's statutory next of kin”,<sup>58</sup> a gift to the class was merely a gift to named persons, namely a private gift. Thus two questions arise here. One is how to distinguish “a class of poor persons” from “particular poor persons” or how wide the class of poor persons shall reach so as to keep a trust beneficial to it charitable? The other is that why “particular poor persons” cannot constitute a class of poor persons or how many particular poor persons can constitute a class of poor persons? Such questions cannot be solved in a reasonable and logical sense and the dividing line drawn in *In re Scarisbrick* and *Dingle v Turner* is nonetheless a mere word-game.

Indeed, the “dividing line” was also criticized as unintelligible by some scholars.<sup>59</sup> Ong illustrated the unintelligible dividing line by giving as an example<sup>60</sup> a case where the trustees were obligated to select in their absolute discretion among a class of beneficiaries comprising all of the testator's poor second cousins. Ong said in this example that although the class of the poor second cousins was only a private class of

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<sup>56</sup> . [1951] 1 Ch 622.

<sup>57</sup> . *Dingle v Turner* [1972] AC 601 at 617.

<sup>58</sup> . *In Re Scarisbrick* [1951] 1 Ch 622 at 651.

<sup>59</sup> . Denis Ong: *Trusts Law in Australia* (2003, 2<sup>nd</sup> ed), p 323.

<sup>60</sup> . *Ibid.*

persons, it was not “a narrow class of near relatives”<sup>61</sup> of the testator. Thus the trust would be a charitable trust because it is for the relief of poverty amongst a particular description of poor people. However, if the testator had named each one of those poor second cousins individually instead of describing his poor second cousins, the trust “would *not* have been a trust ‘for the relief of poverty amongst a class of persons’ but would have been merely a *private* trust for the benefit of ‘*individuals* albeit with relief of poverty amongst those *individuals* as the motive of the gift”<sup>62</sup>.

### 5.2.1.3.3 The implication of the spirit and intendment of the

#### Preamble

As discussed above, except for the fact that the relief of poverty does not need to satisfy the requirement of public benefit in England and Australia, a charitable purpose must simultaneously satisfy both the requirement of public benefit and the requirement of falling within the spirit and intendment of the Preamble to the *Statute of Charitable Uses* 1601 (England).<sup>63</sup>

To decide whether the purpose of a trust falls within the spirit and intendment of the Preamble it must first be decided how to ascertain the spirit and intendment of the Preamble. It is thought that there are two approaches to ascertain whether a purpose is within the spirit and intendment of the Preamble. One is to check directly whether the purported purpose belongs to one of the charitable purposes enumerated in the Preamble. Unsatisfactorily, this approach is too restrictive because the charitable purposes enumerated in the Preamble were limited and, more importantly, the Preamble could not exhaust all the charitable purposes. In *Commissioners for Special*

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<sup>61</sup> . *In Re Scarisbrick* [1951] 1 Ch 622 at 651.

<sup>62</sup> . Denis SK Ong: *Trusts Law in Australia* (2003, 2<sup>nd</sup> ed), p 323. Emphasis added by Ong.

<sup>63</sup> . *Royal National Agricultural and Industrial Association v Chester* (1974) 48 ALJR 304 (per McTiernan, Menzies and Mason JJ in a joint judgement).

*Purposes of Income Tax v Pemsel*,<sup>64</sup> Lord Macnaghten said that “it has never been forgotten that the ‘objects there enumerated’, as Lord Chancellor Cranworth observes, ‘are not to be taken as the only objects of charity but are given as instances’”.<sup>65</sup> That might be a reason why His Lordship there generalized and classified the charitable purposes into only four categories.

In addition, the charitable purposes differ between different times and different places, and the law of charity may change from time to time as Lord Wilberforce declared in *Scottish Burial Reform and Cremation Society v Glasgow Corporation*:<sup>66</sup>

Lord Macnaghten’s grouping of the heads of recognised charity in *Pemsel’s* case is one that has proved to be of value and there are many problems which it solves. But three things may be said about it, which its author would surely not have denied: first that, since it is a classification of convenience, there may well be purposes which do not fit neatly into one or the other of the headings; secondly, that the words used must not be given the force of a statute to be construed; and thirdly, that the law of charity is a moving subject which may well have evolved even since 1891.

Thus, to deal with the purposes which are beneficial to the community but cannot be found in the Preamble, the other approach, the analogy with the enumerated purposes, is adopted to determine whether a particular purpose is or is not within the spirit and intendment of the Preamble. The process of the analogy was expounded by Lord Reid in *Scottish Burial Reform and Cremation Society Ltd v Glasgow Corporation* as follows.<sup>67</sup>

In that case, the central issue was whether the practice of cremation was a charitable purpose within the spirit and intendment of the Preamble. The English House of Lords determined that the practice of cremation was a charitable purpose by the following process of analogy: (1) the House of Lords selected first the charitable

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<sup>64</sup> . [1891] AC 531.

<sup>65</sup> . Ibid, at 581.

<sup>66</sup> . [1968] AC 138 at 154.

<sup>67</sup> . [1968] AC 138 at 147.

purpose of “repair of churches” from the Preamble. (2) They then extended the charitable purpose of “repair of churches” to the maintenance of burial grounds in a churchyard by way of analogy. Thus, the maintenance of burial grounds in a cemetery is also a charitable purpose. (3) At last, the maintenance of burial grounds in a cemetery was extended further to cremation by analogy, because both cremation and burial are methods of disposing of the dead.

This process of analogy was not unimpeachable, because it went a little far. It should be said that at the second stage of the process of analogy, there was no more any link to the original purpose, namely the “repair of churches”, and the cremation had nothing to do with the purpose of “repair of churches”, but the cremation was analogized to the maintenance of burial grounds and held as charitable. If a particular purpose can be ascertained as charitable by analogy to another analogy, how far can such analogy go, the second, third, or the fourth step of the analogy? If such analogy could go on without limitation, the last analogy would have no link with the original purposes enumerated in the Preamble. Because he was not quite persuaded by the process of analogy used in that case, Lord Wilberforce stated that the cremation fell “naturally” within the spirit and intendment of the Preamble because of its public utility.<sup>68</sup>

This approach of analogy was approved by Russell LJ in *Incorporated Council of Law Reporting for England and Wales v Attorney-General*.<sup>69</sup>

In regard to Lord Wilberforce’s view in *Scottish Burial Reform and Cremation Society Ltd v Glasgow Corporation*,<sup>70</sup> Russell LJ deemed it as another approach in addition to the way of analogy. Russell LJ continued:<sup>71</sup>

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<sup>68</sup> . Ibid, at 156.

<sup>69</sup> . [1972] 1 Ch 73 at 87.

<sup>70</sup> . [1968] AC 138 at 156.

<sup>71</sup> . *Incorporated Council of Law Reporting for England and Wales v Attorney-General* [1972] 1 Ch 73 at 87 – 88.

On other occasions a decision in favour or against a purpose being charitable has been based in terms upon a more general question whether the purpose is or is not within “the spirit and intendment” of the Statute of Elizabeth I and in particular its preamble.

Russell LJ here meant to say that whether a particular purpose was charitable or not may sometimes depended on whether the particular purpose naturally or directly falls within the spirit and intendment of the Preamble. However, His Lordship forgot that the target is to ascertain whether a particular purpose is or is not within the spirit of the Preamble, so Russell LJ could not, in logic, use what he wanted to ascertain to prove such ascertainment. Indeed, “it is conceptually circular to say that a purpose is within the spirit of the preamble only if that purpose is within the spirit of the preamble”.<sup>72</sup>

In Australia, it seemed that some judges prefer to ascertain whether a particular purpose is or is not within the spirit and intendment of the Preamble. In *Incorporated Council of Law Reporting of the State of Queensland v Federal Commissioner of Taxation*,<sup>73</sup> Barwick CJ stated:<sup>74</sup>

The reported cases may in some instances afford a guide by analogy to the decision whether a particular trust, or a particular purpose is charitable. In addition, the many dicta found in the reasons for judgement in such cases, though by no means of one accord, provide valuable assistance in resolving such a question. But in the long run, it seems to me, it is a matter of judgement whether the trust or purpose fairly falls within the equity, or as it is sometimes said, “within the spirit and intendment” of the preamble to the Charitable Uses Act 1601 (Imp).

This is clearly so in Australia and it would appear still to be so in England.

However, the application of the approach of analogy is more stringent in Australia. In *Royal National Agricultural and Industrial Association v Chester*,<sup>75</sup> the Australia High Court held that although the gift was beneficial to the community, it failed as a

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<sup>72</sup> . Denis Ong: *Trusts Law in Australia* (2003, 2<sup>nd</sup> ed), p 347.

<sup>73</sup> . (1971) 125 CLR 659.

<sup>74</sup> . Ibid, at 666 – 667.

<sup>75</sup> . (1974) 48 ALJR 304.

charitable trust because it was not within the spirit and intendment of the Preamble. If that case had been decided by the English House of Lords, it might have been held as charitable trust by analogizing it to scientific study.

In the United States, it is not required that the purposes beneficial to the community fall within the spirit and intendment of the Preamble to the *Statute of Charitable Uses* 1601 (England). Section 374 of the *Restatement of Trusts 2d* provides that “a trust for the promotion of purposes which are of a character sufficiently beneficial to the community to justify permitting property to be devoted forever to their accomplishment is charitable”.

The comments on this section suggest:

On the question whether a particular purpose, which does not fall within the previous Sections, falls within the present Section, much depends upon the time and the place at which the question arises. The question in each case is whether at the time when the question arises and in the State in which it arises the purpose is one the accomplishment of which might reasonably be held to be for the social interest of the community.

Thus, in the United States, so long as the accomplishment of the purpose of a trust is reasonably held to be for the social interest of the community at the time and the place it is created, the trust is regarded as a charitable trust. The element of public benefit is the sole criterion to judge whether a particular purpose is or is not charitable. According to this criterion, the comments on section 374 of the *Restatement of Trusts 2d* list and suggest that the following trusts may be regarded as charitable trusts for the promotion of other purposes beneficial to the community: promotion of temperance; relief of animals; promotion of national security; various patriotic purposes; community purposes; trusts for persons of limited opportunities; erection and maintenance of tombs; charities outside the State; change in existing law; political purposes; unpopular causes; promotion of sports.

## 5.2.2 Charitable Purposes under the Civil Law

As discussed above, charitable trusts are called “public benefit trusts” under the Civil Law jurisdictions. It is clear that the purposes of all kinds of charitable trust must satisfy the requirement of public benefit under these jurisdictions.

Although all the Civil Law jurisdictions require charitable trusts to be of public character, the purposes of charitable trusts are not exactly the same within the Civil Law jurisdictions.

In Japan, South Korea and Taiwan, charitable trusts are defined as “the trusts for the purpose of veneration, religion, charity, culture, science, arts or for other purposes beneficial to the public are charitable trusts”.<sup>76</sup> According to these definitions, charitable trusts are divided into the following seven categories: trusts for the advancement of veneration, trusts for the advancement of religion, trusts for purpose of charity, trusts for the advancement of culture, trusts for the advancement of science, trusts for the advancement of arts, and trusts for other purposes beneficial to the public. All the trusts created for these charitable purposes must satisfy the requirement of public benefit.

In regard to the trusts for purpose of charity, as discussed in the above context, it mainly refers to the trusts for the relief of poverty, for the assistance of other persons in the necessitous circumstances. It is similar to that category of trusts which are created for the relief of poverty under the Common Law jurisdictions. Nevertheless, the trusts for purpose of charity in Japan, South Korea and Taiwan are required to satisfy the requirement of public benefit.

With respect to the trusts created for the purpose of veneration, to be charitable they must also satisfy the requirement of public benefit. Veneration is a kind of way

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<sup>76</sup> . The Japanese *Law of Trusts*, article 66; the South Korean *Law of Trusts*, article 65; the *Law of Trusts* of ROC, article 69.

for Eastern people to show their respect to their ancestors. In Eastern society, veneration ceremonies are usually held on some “significant” dates and the scale of the ceremonies varies according to the circumstances. In China, especially in the South-eastern part of China, many families set up the ancestral table to show their respect to their ancestors in their house. In some places, the issues of the same ancestor build the ancestral hall or ancestral temple for the clan to hold veneration ceremonies on certain “significant” dates. In China, some ancestral temples are established or maintained by the government for holding some grand veneration ceremonies. For example, in the Mausoleum of Huang Di (Emperor Huang) in Xian City, Shannxi Province, a veneration ceremony is held every year to memorialize the common ancestor of the Chinese people, Huang Di. On September 28, 2003, another grand veneration ceremony was held at Confucius’s Temple in the hometown of Confucius, Qu Fu City, Shandong Province of China to commemorate the 2554 birthday of Confucius. People even from Korea and Japan attended the ceremony and performed their programmes of memorialisation.

Veneration is different from religious worship, because its aim is to show people’s respect to their ancestors. Veneration of ancestors is a cultural, not a religious, phenomenon. In China, the government usually maintains some ancestral halls or temples in the name of protecting the historical and cultural relics. However, it is easily confused with religion, especially when the veneration ceremonies are mixed with religious activities. For example, in China, it is very common that the statue of Buddha is placed on the ancestral tables or placed in the ancestral halls or temples together with the memorial tablets of the ancestors. That may be the reason why the trusts for the advancement of veneration are singled out as a category of charitable trusts in Japan, South Korea and Taiwan.

A trust for the advancement of veneration shall not be charitable unless the veneration is for the benefit of the public. It is clear that the veneration held within a family or by a clan cannot be regarded as charitable because they lack public benefit. In regard to veneration ceremonies other than those held within a family or by a clan, it is suggested that the public character of the veneration should be determined by all the elements, including the relative elements of culture, history and traditional customs of the nation at the time and place when the trust is created.

Although the *Laws of Trusts* under the Civil Law jurisdictions require that to be charitable the purposes of all kinds of trusts must be beneficial to the public, not all the charitable purposes recognised by trusts law in other Civil Law jurisdictions are also recognized by the Chinese *Law of Trusts*. Article 60 of the Chinese *Law of Trusts* provides:

A trust created for any one of the following purposes beneficial to the public is a charitable trust:

- (1) the relief of poverty; or
- (2) the relief of victims of natural calamities; or
- (3) the assistance to the disabled; or
- (4) the advancement of education, science and technology, culture, arts and sports; or
- (5) the advancement of medical and hygienic business; or
- (6) the advancement of the business of maintenance and protection of ecological environment; or
- (7) the advancement of other businesses beneficial to public.

Viewing the seven categories of charitable trusts provided in this article, the Chinese law of charitable trusts displays several characteristics. First, there is no category of charitable trusts for the purpose of charity as such. In China, the category of trusts for the purposes of charity, which is provided in the *Law of Trusts* of Japan,

South Korea, and Taiwan, is divided into categories of relief of poverty, relief of victims of natural calamities, and assistance to the disabled.

Secondly, there is also no category of the trusts for the advancement of veneration. Because veneration is regarded as a kind of cultural tradition, it is not necessary to list the trusts for the advancement of veneration as a type of charitable trusts in the Chinese *Law of Trusts*. If a trust which is created for the advancement of veneration is beneficial to the public, it is a trust for the advancement of culture. It will be classified into the fourth category of charitable trusts provided for by article 60 of the Chinese *Law of Trusts*.

Thirdly, the trusts for the advancement of religion are not recognized as charitable trusts in China. Although article 36 of the Chinese *Constitution* provides that “citizens of the People's Republic of China enjoy freedom of religious belief” and “the state protects normal religious activities”, people are not encouraged to believe religion because people also enjoy the right not to believe in religion. According to article 36 (2) of the Chinese *Constitution*, “no state organ, public organization or individual may compel citizens to believe in, or not believe in, any religion; nor may they discriminate against citizens who believe in, or do not believe in, any religion”. Thus, it is not strange for China, a “socialist country”<sup>77</sup> to exclude the trusts for the advancement of religion from charitable trusts.

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<sup>77</sup> . The Chinese *Constitution*, article 1.

## 5.3 Categories of Charitable Trusts

### 5.3.1 Categories of Charitable Trusts under the Common Law

The categories of charitable trusts are classified according to the categories of charitable purposes of the trusts. There are mainly two typical kinds of classification of categories of charitable trusts under the Common Law jurisdictions: the classification drawn by Lord Macnaghten in *Commissioners for Special Purposes of the Income Tax v Pemsel*<sup>78</sup> and the classification suggested by the *Restatement of Trusts 2d* of the United States of America.<sup>79</sup> The classification of the categories drawn by Lord Macnaghten is more popular and common and hereinafter the trusts will be examined in the order of this classification. However, the category of the trusts for the advancement of religion will not be discussed because such trusts are not regarded as charitable trusts in China.

#### 5.3.1.1 *The trusts for the relief of poverty*

The first category of charitable trusts, the trusts for the relief of poverty, classified by Lord Macnaghten, was based on the Preamble to the *Statute of Charitable Uses* 1601 (England) which clearly mentioned the following purposes: “for relief of aged, impotent and poor people, for marriages of poor maids, for aid or ease of any poor inhabitants concerning payment of fifteens”.

Because the constitution of a trust for the relief of poverty is not required to satisfy the requirement of public benefit, to ascertain what the term “poverty” means

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<sup>78</sup> . [1891] AC 531 at 583.

<sup>79</sup> . *Restatement of Trusts 2<sup>nd</sup>*, § § 369 – 374.

or what kind of people can be regarded as “poor” people becomes the first starting point to determine whether or not a trust is created for the relief of poverty.

In *In re De Carteret*, Maugham J stated: ““Poor people” is not necessarily confined to the destitute poor”.<sup>80</sup>

Since the “poor people” should not be interpreted as destitute poor people and “poverty” cannot be explained as destitution confined to the destitute poor, the people who are in needy situations shall be considered as poor people within the language or spirit of the Preamble. In *Ballarat Trustees Executors and Agency Company Limited v Federal Commissioner of Taxation*,<sup>81</sup> Kitto J said:<sup>82</sup>

I should say that a person is in necessitous circumstances if his financial resources are insufficient to enable him to obtain all that is necessary, not only for a bare existence, but for a modest standard of living in the Australian community.

In respect of the “poverty”, Evershed MR declared in *In re Coulthurst, Decd* that:<sup>83</sup>

It is quite clearly established that poverty does not mean destitution; it is a word of wide and somewhat indefinite import; it may not unfairly be paraphrased for present purposes as meaning persons who have to “go short” in the ordinary acceptance of that term, due regard being had to their status in life, and so forth.

Actually, the terms “in necessitous circumstances” and “modest standard of living” are as vague as the terms of “poverty” and “poor”. To determine whether or not a person in a purported trust for the relief of poverty is poor should consider all the relative circumstances at the place and at the time when the trust is created.

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<sup>80</sup> . [1933] 1 Ch 103 at 111-112.

<sup>81</sup> . (1950) 80 CLR 350.

<sup>82</sup> . Ibid at 355.

<sup>83</sup> . [1951] 1 Ch 661 at 665 – 666.

### **5.3.1.2 The trusts for the advancement of education**

The category of trusts for the advancement of education is mainly based on the following phrases in the Preamble to the *Statute of Charitable Trusts* 1601 (England): “for schools of learning, for free schools and scholars in universities, and for education and preferment of orphans”. To be charitable, the purpose of a trust for the advancement of education must meet simultaneously two requirements: beneficial to the community and educational. The former requirement has been discussed in the above context of this Chapter. With respect to the requirement of education, the main issue is what constitutes education in the law of charitable trusts.

The general meaning of education means the process of dissemination or acquisition of knowledge and skill which usually involves the teaching and learning. Under the traditional view, the validity of trusts for the advancement of education depends on knowledge not merely having been accumulated but also imparted by means of instruction. *In Re Shaw, decd*, Harman J held that a trust, which was created for the purpose of investigation how much time and money would be saved by using a new alphabet consisting of at least 40 letters, was not for the purpose of advancement of education because although the sum total of knowledge may have been increased, it would not necessarily have advanced knowledge nor was there any element of teaching or education.<sup>84</sup>

The view of Harman J in *Re Shaw* was also criticized as placing “some limits upon the extent to which a gift for research may be regarded as charitable” by Wilberforce J in *In re Hopkins’ Will Trusts*.<sup>85</sup> In referring to Harman J’s judgement in *Re Shaw*, Wilberforce J there said, “I should be unwilling to treat them as meaning that the promotion of academic research is not a charitable purpose unless the

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<sup>84</sup> . [1957] 1 WLR 729 at 738.

<sup>85</sup> . [1965] 1 Ch 669 at 680.

researcher were engaged in teaching or education in the conventional meaning ... I think therefore, that the word 'education' as used by Harman J ... must be used in a wide sense, certainly extending beyond teaching".<sup>86</sup>

In fact, earlier than *Re Shaw*, the Australian High Court in *Taylor v Taylor*<sup>87</sup> upheld a gift towards the advancement of scientific research as a trust for the advancement of education.

The traditional view of education declared by Harman J in *Re Shaw, decd*<sup>88</sup> was changed in *Inland Revenue Commissioners v McMullen*.<sup>89</sup> In that case, a trust to encourage pupils at schools and students and universities to play games and sports so as to ensure that they received physical education and mental development was upheld as a trust for the advancement of education. With respect to the objects of education, Lord Hailsham there stated:<sup>90</sup>

[T]he picture of education when applied to the young which emerges is complex and varied, but not ... "elusive". It is the picture of a balanced and systematic process of instruction, training and practice containing ... both spiritual, moral, mental and physical elements, the totality of which in any given case may vary with, for instance, the availability of teachers and facilities, and the potentialities, limitations and individual preferences of the pupils. But the totality of the process consists as much in the balance between each of the elements as in the enumeration of the thing learned or the places in which the activities are carried on. I reject any idea which would cramp the education of the young within the school or university syllabus, confine it within the school or university campus, limit it to formal instruction, or render it devoid of pleasure in the exercise of skill.

The wide view of education extends the traditional view of education which involves the teaching or learning to education in a specific field such as the promotion of education in particular subjects.

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<sup>86</sup> . Ibid, at 680.

<sup>87</sup> . (1910) 10 CLR 218

<sup>88</sup> . [1957] 1 WLR 729 at 738.

<sup>89</sup> . [1981] AC 1.

<sup>90</sup> . Ibid, at 18

### **5.3.1.3 The trusts for the purposes beneficial to the community**

The trusts for the purposes beneficial to the community were classified as the fourth category of the charitable trusts by Lord Macnaghten in *Commissioners for Special Purposes of the Income Tax v Pemsel*.<sup>91</sup> The trusts which fall within this category are charitable trusts, but not all the trusts for the purposes beneficial to the community are charitable trusts. As discussed above, only those trusts which are beneficial to the community as well as within the spirit and intendment of the Preamble to the *Statute of Charitable Uses* 1601 (England) are charitable trusts.

In *Attorney-General v National Provincial and Union Bank of England*,<sup>92</sup> Viscount Cave LC explained Lord Macnaghten's fourth category of charitable trusts as follows:<sup>93</sup>

Lord Macnaghten did not mean that all trusts for purposes beneficial to the community are charitable, but that there were certain charitable trusts which fell within that category; and accordingly to argue that because a trust is for a purpose beneficial to the community it is therefore a charitable trust is to turn round his sentence and to give it a different meaning.

Thus, in *Royal National Agricultural and Industrial Association v Chester*,<sup>94</sup> the Australian High Court held that a charitable purpose should be both beneficial to the community and within the spirit and intendment of the Preamble and "the existence of these two elements is both necessary and sufficient to warrant the conclusion that a particular purpose is charitable in law".<sup>95</sup>

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<sup>91</sup> . [1891] AC 531 at 583.

<sup>92</sup> . [1924] AC 262.

<sup>93</sup> . Ibid, at 265.

<sup>94</sup> . (1974) 48 ALJR 304.

<sup>95</sup> . Ibid, at 305 (per McTiernan, Menzies and Mason JJ in a joint judgement).

The fourth category of charitable trusts involves numerous cases, such as the trusts for the beautification and advancement of the township of Bunyip,<sup>96</sup> for agricultural showground,<sup>97</sup> for the Australia Red Cross,<sup>98</sup> for the community in Australia,<sup>99</sup> etc.

Traditionally, the element of public benefit of a trust for the purpose beneficial to the community under the fourth category is more stringent than that of a trust for the advancement of education or religion, which is may be required only satisfied a section of public.

In *Inland Revenue Commissioners v Baddeley*,<sup>100</sup> Viscount Simonds stated:<sup>101</sup>

[A]bridge which is available for all the public may undoubtedly be a charity and it is indifferent how many people use it. But confine its use to a selected umber of person, however numerous and important: it is then clearly not a charity. It is not of general public utility: for it does not serve the public purpose which its nature qualifies it to serve.

In the same case, Lord Somervell of Harrow said a trust for the purpose beneficial to the community would be normally for the public or all members of the public and a section of the public which was sufficient to support a valid charitable trust in a category was not necessarily sufficient to support a charitable trust in another category.<sup>102</sup>

However, with respect to the trusts for the purpose of recreation, this view has been modified by statutes in England and Australia.<sup>103</sup> For example, section 103 (2) the *Trusts Act 1973* (Qld) provides that it shall be deemed to have been charitable to provide, or to assist in the provision of, facilities for recreation or other leisure time

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<sup>96</sup> . *Schellenberger v Trustees Executors and Agency Co Ltd* (1952) 86 CLR 454.

<sup>97</sup> . *Brisbane City Council v Attorney-General of Queensland* (1978) 52 ALJR 599.

<sup>98</sup> . *Australia Red Cross Society v Albury City Council* (1973) 28 LGRA 211.

<sup>99</sup> . *Commissioner of Stamp Duties (NSW) v Way* (1951) 83 CLR 570.

<sup>100</sup> . [1955] AC 572.

<sup>101</sup> . *Ibid*, at 592.

<sup>102</sup> . *Ibid*, at 615.

<sup>103</sup> . See, for example: *Recreational Charities Act 1958* (UK); *Trusts Act 1973* (Qld); *Charitable Trusts Act 1962* (WA); *Trustee Act 1936* (SA).

occupation. Section 103 (4) of the *Act* further provides: “Nothing in this section shall be taken to derogate from the principle that, in order to be charitable, a gift, trust or institution must be for the public benefit”.

Apart from modifying the above traditional and orthodox view, the statutes also relieve the trusts for mixed charitable and non-charitable purposes from the strict general law.

Under the general law, a trust for charitable and non-charitable purposes would fail because charitable trusts should be exclusively for charitable purposes or the trust property might not be spent on the non-charitable purposes.<sup>104</sup> However, if the non-charitable purpose is a purely incidental purpose to the charitable purpose, the trust is still a valid charitable trust. In *Bathurst City Council v PWC Properties Pty Ltd*, it was held that a non-charitable purpose which is co-incidentally served with the charitable purpose would not destroy the charitable nature of the trust.<sup>105</sup>

In addition, the statutes of Australia<sup>106</sup> allow the non-charitable purposes to be severed from the charitable purposes so that the remaining charitable purposes will be exclusive and the trust will be upheld.

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<sup>104</sup> . *Morice v Bishop of Durham*, (1804) 9 Ves 399; 32 ER 656.

<sup>105</sup> . (1998) 72 ALJR 1470 at 1478 (per Gaudron, McHugh, Gummow, Hayne and Callinan JJ in a joint judgement).

<sup>106</sup> . *Variation of Trusts Act* 1994 (Tas), s 4 (2) and (3); *Charitable Trusts Act* 1993 (NSW), s 23; *Trusts Act* 1973 (Qld), s104; *Trustees Act* 1962 (WA), s 102; *Property Law Act* 1958 (Vic), s 131; and *Trustee Act* 1936 (SA), s 69A.

## **5.3.2 Categories of Charitable Trusts under the Civil Law**

### **5.3.2.1 *The categories of charitable trusts in Japan, South Korea and Taiwan***

Under the Civil Law Jurisdictions, the categories of charitable trusts correspond to the categories of the charitable purposes. Therefore, in Japan and South Korea, the charitable trusts are classified as the following six categories: the trusts for religion, the trusts for veneration, the trusts for charity, the trusts for science, the trusts for arts, and the trusts for other public benefits.<sup>107</sup> In Taiwan, in addition to the above six categories of trusts provided for by the Japanese and South Korean *Law of Trusts*, the trusts for the advancement of culture are also regarded as charitable trusts.<sup>108</sup>

### **5.3.2.2 *The categories of charitable trusts in China***

In China, similarly, charitable trusts are also divided into seven categories according to the charitable purposes enumerated in Article 60 of the Chinese *Law of Trusts*, namely the relief of poverty; the relief of victims of natural calamities; the assistance to the disabled; advancement of education, science and technology, culture, arts and sports; the advancement of medical and hygienic business; the advancement of the business of maintenance and protection of ecological environment; the advancement of other purposes beneficial to the public.

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<sup>107</sup> . The Japanese *Law of Trusts*, article 66; the South Korean *Law of Trusts*, article 65.

<sup>108</sup> . The *Law of Trusts* of ROC, article 69.

However, as mentioned above, the classification of charitable trusts in China is different from that of Japan, South Korea and Taiwan. Briefly speaking, first, trusts for the advancement of veneration and religion are not recognized as charitable trusts. Secondly, there is no concept of trusts for charity. In China, the category of trusts for charity provided for by the *Law of Trusts* of Japan, South Korea and Taiwan are further divided into the trusts for the relief of poverty, the relief of victims of natural calamities, and the assistance to the disabled. Thirdly, the classification drawn by the Chinese *Law of Trusts* is more detailed. It does not only provide for the trusts for the advancement of education, science, culture, arts and sports, but also specifically provides for the trusts for the advancement of medical and hygienic business and for the advancement of maintenance and protection of environment.

With respect to the seven categories of charitable trusts, two things will be explained in further detail. One is the seventh category of charitable trusts, namely the trusts for other purposes beneficial to the public; the other is the standard of determining poverty.

#### **5.3.2.2.1 The seventh category of charitable trusts**

The seventh category of charitable trusts provided for by article 60 of the Chinese *Law of Trusts* refers to all the other charitable trusts excluded from the first six categories of charitable trusts. To fall within this category, a trust must be created for the purpose beneficial to the community, such as to build a bridge, a recreation centre for the community, or to set up a children or aged care centre.

In regard to the element of public benefit, it is suggested that two elements should be considered. First, only the purpose which is directly rather than indirectly beneficial to the community can be regarded as a charitable purpose, because many purposes can be regarded as indirectly beneficial to the community. For example, to

set up an enterprise in a town will certainly be beneficial to the community because it will relieve the employment problem of the town and pay more tax to the town. However, the investor may also earn profit from the investment. In this case, the public benefit is indirect, so the investment purpose cannot be regarded as a charitable purpose.

Secondly, the public benefit purpose may be charitable even the purpose is only for a section of public. For example, where a testator left his legacy to build an aged recreation club which provides that only those who are residents of Hook Shire and over 60 are permitted to enter, it should be regarded as a charitable trust although the public benefit purpose of the trust is limited to the age, over 60, and to the area, Hook Shire.

#### **5.3.2.2.2 The definition of poverty**

Poverty is an abstract concept. In its general sense, poverty means poor situation. Thus “poor people” or “people of poverty” refer to people in necessitous circumstances. When the court determines whether a person is in a circumstance of poverty, it has to consider all the conditions or situations relative to the moderate living standard of the area and the period in and at which the person lives.

In China, it is easier for courts to decide whether a person is poor or not, because the local governments of China have laid down specific criteria for the identification of “poverty”. In China, all the local governments have enacted regulations to provide for the lowest wage lines for enterprises workers whereby the workers cannot be paid lower than these lines. These lowest wage lines indicate the lowest living standard in different areas during specified periods. Thus, whether or not a person is in necessitous circumstances can be judged by the lowest wage lines. The following table is about the lines drawn by the local governments representing Beijing,

Shanghai, and the richest and poorest capital cities of China, Guangzhou and Guiyang.<sup>109</sup>

Cities	Lowest Wage Lines [unit: Yuan (RMB)] <sup>110</sup>	Effective Time
Beijing	465 per month	From July, 2002
Shanghai	570 per month	From Jun, 2003
Guangzhou	500 per month	From October, 2002
Guiyang	350 per month	From September, 2002

It is noteworthy that these lowest wage lines provided for by the local governments may be modified according to different periods. For example, in 2001, the lowest wage line of Beijing was 435, and in 2002, the lowest wage line of Shanghai was 535.

In addition, a lowest wage line does not mean that a person cannot live if what he/she earns is under the lowest wage line. For example, in Beijing, the lowest wage line is 465 *Yuan* (RMB) per month which means a person is in “poor” situation if he/she cannot earn 465 *Yuan* (RMB) per month. In some cities of China, apart from providing for the lowest wage lines of enterprises workers, the regional governments also provide for the lowest living sustainable line for unemployed people. For example, in 2001, the Beijing government provided that the lowest living sustainable

<sup>109</sup>. Resources were retrieved from: <http://www.china.com.cn/chinese/difang/353910.htm>;  
<http://business.sohu.com/59/88/article203728859.shtm>;  
<http://www.unn.com.cn/GB/channel1265/267/805/200209/19/21427.html>.

<sup>110</sup>. 100 Australian dollars = about 590.57 Chinese Yuan (according to the foreign exchange rate of the Bank of China issued on August 10, 2004. Retrieve from <http://www.bank-of-china.com>.

line for unemployed people is 305 *Yuan* (RMB) per month.<sup>111</sup> Thus, if a person cannot have 305 *Yuan* (RMB) per month, he/she is destitute.

Either way, the lowest wage lines drawn by local government of China provide for a specific standard for courts to determine who is poor and who is not.

## **5.4 The Application of the Cy-Pres Doctrine**

Under the law of charitable trusts, the cy-pres doctrine means where a specific purpose of a charitable trust cannot be carried out literally, the court will apply cy-pres scheme, namely to apply the trust property to another purpose which is as near as possible to the original specific purpose. The cy-pres doctrine is a peculiar scheme of the law of charitable trusts under the Common Law. The aim of cy-pres is to rescue a charitable trust from failed specified purpose. The cy-pres doctrine exists in the law of trusts both of the Common Law and the Civil Law jurisdictions.

### **5.4.1 The Cy-Pres Doctrine under the Common Law**

Under general law, the cy-pres doctrine may be applied to a charitable trust in the following two circumstances: where there are initial impossibility and subsequent impossibility to carry out the purported purpose of the charitable trust.

#### ***5.4.1.1 Initial impossibility***

The initial impossibility refers to that it is impossible or impracticable to carry out the purpose specified in the charitable trust from the outset. There are many cases in which a charitable purpose cannot be carried out from the outset. For example, the initial impossibility may occur where the trust fund is insufficient to carry out the

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<sup>111</sup> . Retrieved from: <http://finance.sina.com.cn/g/20011102/124476.html>

purported charitable purpose; the object to which the purported charitable purpose aims to accomplish does not exist; or such object has already been accomplished.

However, not all the charitable trust of which the purposes are initially impossible to be achieved can be applied cy-pres scheme. To apply the cy-pres scheme to the initial impossibility of a charitable trust, there must be a paramount general charitable intention.

In *Attorney-General for New South Wales v Adams*,<sup>112</sup> Isaacs J<sup>113</sup> quoted the principle stated by Kay J in *Re Taylor; Martin v Freeman*<sup>114</sup> which reads as follows:

“If upon the whole scope and intent of the will you discern the paramount object of the testator was to benefit not a particular institution, but to effect a particular form of charity independently of any special institution or mode, then although he may have indicated the mode in which he desires that to be carried out, you are to regard the primary paramount intention chiefly, and if the particular mode for any reason fails, the court, if it sees a sufficient expression of a general intention of charity, will, to use the phrase familiar to us, execute that *cy-près*, that is, carry out the general paramount intention in some way as nearly as possible the same as that which the testator has particularly indicated without which his intention itself cannot be effectuated”.

Thus, the existence of a paramount general charitable intention is the requirement of application of cy-pres to the case where the initial impossibility occurs. The statement of Kay J was refined by Dixon and Evatt JJ in *Attorney-General (NSW) v Perpetual Trustee Co. (Ltd)*.<sup>115</sup>

In that case, a testatrix bequeathed her property for a training farm for orphan lads being Australians. The purported purpose was initially impracticable because “the homestead was too small, the plant was too old-fashioned, and the income produced would not sufficient to support the staff and to meet the expenses thought necessary

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<sup>112</sup> . (1908) 7 CLR 100.

<sup>113</sup> . Ibid, at 124 – 125. This quotation was cited by Latham CJ in *Royal North Shore Hospital of Sydney v Attorney-General (NSW)* (1938) 60 CLR 396 at 414.

<sup>114</sup> . (1888) 58 LT 538 at 543.

<sup>115</sup> . (1940) 63 CLR 209.

for the project”.<sup>116</sup> The question, thus, arose as to whether or not there was a paramount general charitable intention. The High Court of Australia, per Rich, Dixon, Evatt and Mc Tiernan JJ (Latham CJ and Starke J dissenting) held that the original charitable intention of the testatrix “did not form an essential or indispensable condition of the gift, which was dominated by a more general charitable intention of providing for the training of Australian orphan lads in farming pursuits, a guiding purpose to the fulfilment” of the original charitable intention of the testatrix.<sup>117</sup> Therefore, since the property was unsuitable as a training farm, the trust should be applied cy-pres.

Dixon and Evatt JJ there held that if a literal execution of a charitable purpose was initially impracticable, the issue raised was whether the directions or desires of the author of the trust were essential to the purpose of the trust. If, based on the words used in the instrument and the surrounding circumstances, the literal execution of the trust was essential and the trust was initially impossible, the trust would fail. On the contrary, however, if the directions or desires of the author of the trust were not essential but were the means to achieve a wider general purpose and the wider general purpose was dominant, the trust should be applied cy-pres.

In their joint judgement, Dixon and Evatt JJ stated:<sup>118</sup>

If there are insuperable objections, either of fact or of law, to a literal execution of a charitable trust it at once becomes a question whether the desires or directions of the author of the trust, with which it is found impracticable to comply, are essential to his purpose. If a wider purpose forms his substantial object and the directions or desires which cannot be fulfilled are but a means chosen by him for the attainment of that object, the court will execute the trust by decreeing some other application of the trust property to the furtherance of the substantial

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<sup>116</sup> . Ibid, at 209.

<sup>117</sup> . Ibid, at 209.

<sup>118</sup> . *Attorney-General (NSW) v Perpetual Trustee Co. (Ltd.)* (1940) 63 CLR 209 at 225.

purpose, some application which departs from the original plan in particulars held not essential and, otherwise, keeps as near thereto as may be.

With respect to determining whether the wider general intention is or is not the substantial purpose, Dixon and Evatt JJ said it depended on the construction of the terms of the trust instrument together with any extrinsic circumstances admissible in aid of construction.<sup>119</sup>

It is noteworthy that the wider general charitable intention does not mean an intention beneficial to charity generally; rather, it simply means an intention that is wider than the charitable intention disclosed in the literal terms of the trust.<sup>120</sup>

In dissent, Latham CJ and Starke J held that no paramount general charitable intention could be found. They thought that it was always possible to obtain a general charitable intention by a process of abstraction, so it was necessary to find an expression of a general charitable intention before applying cy-pres scheme. Latham CJ there clearly stated:<sup>121</sup>

In every case of a charitable gift there is a charitable intention. By a process of abstraction it is always possible to disengage that intention in the case of any particular gift and then to argue that the intention so discovered is an intention which is general and not particular in character...

Before the cy-pres doctrine can be applied it is necessary to find an expression of a general charitable intention in addition to a particular charitable intention. It must be possible to hold that notwithstanding the failure of the particular means mentioned in the will or other instrument for the effectuation of the charitable intention, there is an expression of a general charitable intention, even though it may be impracticable to give effect to the intention by such means.

It is true that any particular charitable intention embodies a general charitable intention and it is true that, logically, the view of Latham CJ is correct. However, the

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<sup>119</sup> . Ibid, at 227.

<sup>120</sup> . Ibid, at 225.

<sup>121</sup> . Ibid, at 216 – 217.

approach delineated by Latham CJ is too narrow, because if there is no “an expression of a general charitable intention in addition to a particular charitable intention”, no general charitable intention can even be inferred. Latham CJ, in fact, followed the view stated by Kay J in *Re Taylor; Martin v Freeman*,<sup>122</sup> which says that if the court saw a sufficient expression of a general intention of charity, it would execute the cy-pres. The view was also stated by Parker J in *In re Wilson*,<sup>123</sup> which reads:

I have to determine whether the gift in this will, which is in form a particular gift, is a gift really for a particular charitable purpose, and for that purpose only, or whether there is a paramount intention to be gathered from the will that the money shall in any event be applied for some more general charitable purpose even if the particular mode of application which is prescribed cannot be carried into effect.

Nevertheless, in determining whether there is a paramount general intention, the courts cannot be limited to the “expression” or the “will” of the creator of the trust. They shall also consider the social value of charitable trusts. It is the social value of the charitable trusts that makes the courts always leans in favour of charity and the attitude of the courts in favour of charity has been lucidly declared by Buckley J in *In re Davis*<sup>124</sup> as follows:

[T]he principle... is, that where you find a gift to a charitable institution which never existed, the Court, which always leans in favour of charity, is more ready to infer a general charitable intention than to infer the contrary.

#### **5.4.1.2 Subsequent impossibility**

The subsequent impossibility means a charitable purpose is initially possible but subsequent impossible. It occurs, for example, where a trust was established to maintain a church, but the church then was destroyed because of earthquake, or where

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<sup>122</sup> . (1888)58 LT 538 at 543.

<sup>123</sup> . (1913) 1 Ch 314 at 321.

<sup>124</sup> . [1902] 1 Ch 876 at 881.

a trust was established to build a hospital, but there remained surplus after the construction of the hospital.

In the case of subsequent impossibility, because the original charitable purpose has already taken effect, there is no need under the general law to show a general charitable intention. If the original purpose was initially possible, the subsequent failure of the purpose will result in the application of cy-pres scheme.

In *Beggs v Kirkpatrick*,<sup>125</sup> Adam J quoted many authorities and clearly explained:<sup>126</sup>

In determining what may properly be done with charitable funds which cannot be applied as contemplated by the donors, it is, as appears from the authorities, important to ascertain whether the charitable purpose has taken effect and subsequently failed, or whether the purpose has altogether failed to take effect.

In the former case where the fund may be considered to have once vested in charity, or been effectively dedicated to charity, there is strong authority for the view that the court has jurisdiction to direct an application cy-pres of funds belonging to that charity and that it is relevant to consider whether donations to it had been made originally for a specific purpose only, or with some more general charitable intention.

Similarly, Buckley J also pointed out it is no need to exhibit a general charitable intention in subsequent impossibility in *Re Lysaght*,<sup>127</sup> by saying:

Since *Re Robinson* [1923] 2 Ch 332 was decided it has been recognised that different considerations govern the application of the cy-pres doctrine when impracticability supervenes after the charitable trust has once taken effect from those which apply in cases of initial impracticability. In cases of supervening impracticability it matters not whether the original donor had or had not a general charitable intention.

It can be said that the distinction between an initial impossibility and subsequent impossibility as to the application of cy-pres scheme depends on whether the failed

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<sup>125</sup> . [1961] VR 764.

<sup>126</sup> . Ibid, at 767.

<sup>127</sup> . [1966] Ch 191

original charitable purpose embodies a paramount general charitable purpose. In the case of initial impossibility, the existence of an essential wider general charitable purpose is the prerequisite of application of cy-pres, while in the case of subsequent impossibility, it is not required that there must be a general charitable purpose.

Unlike the general law in England and Australia, the trusts law in the United States of America provides that the application of cy-pres doctrine requires the existence of a general charitable purpose in both cases of initial and subsequent impossibility. Section 399 of the *Restatement of Trusts 2d* provides:

If property is given in trust to be applied to a particular charitable purpose, and it *is or becomes*<sup>128</sup> impossible or impracticable or illegal to carry out the particular purpose, and if the settlor manifested a more general intention to devote the property to charitable purposes, the trust will not fail but the court will direct the application of the property to some charitable purpose which falls within the general charitable intention of the settlor.

However, the *Restatement* explains that in the case of subsequent impossibility, “it is easier to find a more general charitable intention of the settlor than it is where the particular purpose fails at the outset”.<sup>129</sup> In addition, the *Restatement* says, “as a matter of public policy it might well be held that in the case of subsequent failure of the particular purpose the doctrine of cy-pres should always be applied and that the property should never revert to the settlor or his estate”.<sup>130</sup>

It seems that in the USA, although it is required to exhibit the general charitable intention of the settlor in applying the cy-pres to the subsequent impossibility, as a matter of public policy, the cy-pres can be still applied to the subsequent impossibility even if no such general charitable intention can be inferred, since “the doctrine of cy-pres should always be applied”. However, to correctly understand the spirit of section 399 of the *Restatement of Trusts 2d*, the exhibition of the general charitable intention

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<sup>128</sup> . Emphasis added.

<sup>129</sup> . Comments on section 399 of the *Restatement of Trusts 2d*.

<sup>130</sup> . Ibid.

of the settlor should be a requirement of applying cy-pres doctrine although it is very easy to find such general charitable intention.

### **5.4.1.3 The statutory cy-pres**

In England and Australia, the cy-pres doctrine under general law was modified by statutes<sup>131</sup> in certain aspects or to certain extends and the Australian statutes differ slightly between themselves.

The typical provision for statutory cy-pres doctrine is section 105 of the *Trusts Act* 1973 (Qld), which together with section 5 of the *Variation of Trusts Act* 1994 (Tas) and section 2 of the *Charities Act* 1978 (Vic), are based on the section 13 of the *Charities Act* 1960 (UK) which is now the *Charities Act* 1993 (UK). Section 105 (1) and (2) of the *Trusts Act* 1973 (Qld) provides:

- (1) Subject to subsection (2), the circumstances in which the original purposes of a charitable trust can be altered to allow the property given or part of it to be applied cy pres shall be as follows—
  - (a) where the original purposes, in whole or in part—
    - (i) have been as far as may be fulfilled; or
    - (ii) can not be carried out; or
    - (iii) can not be carried out according to the directions given and to the spirit of the trust;
  - (b) where the original purposes provide a use for part only of the property available by virtue of the trust;
  - (c) where the property available by virtue of the trust and other property applicable for similar purposes can be more effectively used in conjunction, and to that end can suitably, regard being had to the spirit of the trust, be made applicable to common purposes;
  - (d) where the original purposes were laid down by reference to an area which then

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<sup>131</sup> . *Charities Act* 1993 (UK); *Variation Trusts Act* 1994 (Tas); *Charitable Trusts Act* 1993 (NSW); *Charities Act* 1978 (Vic); *Trusts Act* 1973 (Qld); *Charitable Trusts Act* 1962 (WA); *Trusts Act* 1936 (SA).

was but has since ceased to be a unit for some other purpose, or by reference to a class of persons or to an area which has for any reason since ceased to be suitable, regard being had to the spirit of the trust, or to be practical in administering the trust;

(e) where the original purposes, in whole or in part, have, since they were laid down—

(i) been adequately provided for by other means; or

(ii) ceased, as being useless or harmful to the community or for other reasons, to be in law charitable; or

(iii) ceased in any other way to provide a suitable and effective method of using the property available by virtue of the trust, regard being had to the spirit of the trust.

(2) Subsection (1) shall not affect the conditions which must be satisfied in order that property given for charitable purposes may be applied cy pres, except in so far as those conditions require a failure of the original purposes.

The essential modification made by section 105 of the *Trusts Act 1973* (Qld) is the provisions of subsection (2). Under general law, a cy-pres scheme can only be applied where there exists the initial or subsequent impossibility. If there is no initial or subsequent impossibility, there is no application of cy-pres. According to section 105 (2) of the *Trusts Act 1973* (Qld), if the conditions are met, the purpose may be applied cy-pres even if there is no initial or subsequent impossibility.

However, the essential modification may only be taken place in limited circumstances. For example, section 105 (1) (c) provides that where property is given to a trust and property is given by another trust for similar purposes, and the property can be effectively be used in conjunction with one another, one of the purpose may be applied cy-pres even if there is no initial impossibility of the purpose. In addition, section 105 (2) does not mean that the cy-pres can be still applied to where there is no initial impossibility even if there is no general charitable intention. The statutory cy-

pres cannot invalidate the rule that a paramount general charitable intention is a requirement of applying cy-pres to an initial impossibility.

Whilst, in South Australia, the statutory cy-pres may go further because it does not even require the general charitable intention in the relevant trust. According to section 69B (6) of the *Trustee Act 1936* (SA), the trust property may be applied cy-pres scheme without the exhibition of general charitable intention so long as any or more of the events provided for in section 69B (1) from (a) to (e) have occurred.<sup>132</sup>

In New South Wales, section 9 of the *Charitable Trusts Act 1993* (NSW) widens the basis of application of cy-pres doctrine from “the initial impossibility of the original purpose” to “ceased to provide a suitable and effective method of using the trust property, having regard to the spirit of the trust”.

In Western Australia, according to section 7 of the *Charitable Trusts Act 1962* (WA), a cy-pres scheme may be applied where there is no exhibition of a general charitable purpose.

## 5.4.2 The Cy-Pres Doctrine under the Civil Law

The cy-pres doctrine has also been accepted at the time when the Civil Law jurisdictions accepted and enacted their *Law of Trusts*. Article 72 of the Chinese *Law of Trusts* provides:

Where, upon the termination of a charitable trust, there is no person in whom the trust property is to vest or such person is unspecified social public, the trustee shall, on the approval of the administrative office of charitable business, apply the trust property to another purpose

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<sup>132</sup>. Section 69 B (1) (a) to (e) provide that “the original purposes in whole or part have been as far as possible fulfilled or cannot be carried out; the original purposes provide the use of party only of the trust property; the trust property could be more effectively used if combined with other property applicable for similar purposes and administered jointly with that property; where it is not reasonably practicable to apply the trust property in accordance with the original purposes; and the original purpose in whole or in part have been adequately provided for by other means, have ceased to be charitable purposes, or have ceased to provide a suitable and effective method of using the trust property”.

which is as near as possible to the original charitable purpose, or transfer the trust property to another charitable organization which is of the similar purpose or to another charitable trust.

In Japan, South Korea, China and Taiwan, the cy-pres doctrine is regarded as a scheme to continue a terminated charitable trust. For example, article 73 of the Japanese *Law of Trusts*, which is entitled as the “continuance of trust”, provides:<sup>133</sup>

If, upon termination of a charitable trust, there exists no person in whom the trust property is to vest, the competent government office may cause the trust to be continued for a similar purpose, which is not contrary to the tenor and purport of the original trust.

In the light of the provisions for cy-pres under the Civil Law jurisdictions, it is clear that, with respect to the application of cy-pres doctrine, the law of trusts under the Common Law fundamentally differs from that under the Civil Law in two aspects: the circumstances under which the cy-pres doctrine is applied and the requirement of the exhibition of the general charitable purpose.

#### **5.4.2.1 The circumstances under which the cy-pres is applied**

The trusts law in the Civil Law jurisdictions prescribe a condition precedent to the application of the cy-pres doctrine which requires that there is no any person in whom the trust property is to vest after the termination of the trust. Thus, under the Civil Law, where there are circumstances under which the charitable trust is terminated and no person can be found to take the trust property as absolute owner, a cy-pres scheme shall be executed and the trust property shall be applied to another similar charitable purpose or shall be transferred to another charitable legal person or another charitable trust which is engaging in similar charitable purpose. On the contrary, if the trust property can be vested in a person or certain persons after the charitable trust terminates, there is no issue of the application of the cy-pres scheme. The condition

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<sup>133</sup> . See also the South Korean *Law of Trusts*, article 72 and the *Law of Trusts* of ROC, article 79.

precedent is the fundamental distinction between the application of cy-pres doctrine under the Civil Law and the Common Law jurisdictions.

Under the Common Law jurisdictions, the application of cy-pres is not for the reason that the charitable trust itself terminates, nor for the reason that there is no person to be vest in the trust property, but for the reason that the specific charitable purpose of the trust cannot be carried out literally by virtue of initial or subsequent impossibility. In the case of initial impossibility, the application of cy-pres also needs to satisfy the requirement of the presence of a paramount general charitable intention. Thus, where the original charitable purpose of a charitable trust failed initially, the cy-pres doctrine cannot be applied if there is no evidence of a paramount general charitable intention. In the case of subsequent impossibility, the trust property will be applied to another charitable purpose no matter whether or not there exists a paramount general charitable purpose.

Under the Common Law, where the original charitable purpose of a trust cannot be carried out by reason of initial impossibility, and there is a paramount of charitable intention, or of subsequent impossibility, it is the charitable purpose itself, rather than the charitable trust, that is regarded as failed. The aim to devise the cy-pres doctrine is to rescue the charitable trust from failure. Because the charitable trust is not regarded as failed, even if there were persons in whom the trust property could vest, the trust property would be applied cy-pres rather than vest in such persons. That explains the reason why the charitable purpose can be continued under the cy-pres doctrine.

Under the Civil Law jurisdictions, since the termination of the charitable trust and the non-existence of any vested person of the trust property are the prerequisites of applying cy-pres doctrine, it is, logically, contradictory to say to cause a charitable trust to be continued by applying cy-pres scheme in that the charitable trust has

already terminated. It seems that the application of cy-pres doctrine is the creation of a new charitable trust rather than the continuance of the original charitable trust.

Thus, it is suggested that the Chinese *Law of Trusts* should accept the concepts of initial impossibility and subsequent impossibility under the Common Law to replace the concept of the termination of charitable trust so as to avoid the contradictory wording in the Chinese *Law of Trusts*.

#### **5.4.2.2 The requirement of the general charitable purpose**

Although, under the Common Law, the application of cy-pres scheme in the case of subsequent impossibility does not need the existence of a paramount general charitable intention, in the case of initial impossibility, to determine whether or not the creator of the charitable trust has exhibited a paramount general charitable intention is the requirement for making a cy-pres scheme.

Under the Civil Law, because there is no distinction between an initial impossibility and a subsequent impossibility, nor is there consideration of the question as to whether or not there is a paramount general charitable intention, it seems, practically, that the application of cy-pres under the Civil Law jurisdictions is much simpler than that under the Common Law, because it does not require ascertaining whether or not there is a paramount general charitable intention.

However, the *Law of Trusts* in Japan and South Korea requires that the application of cy-pres doctrine cannot be “contrary to the tenor and purport of the original charitable trust”.<sup>134</sup> Thus two questions as to what the term “tenor” or “purport” means and as to whether the “tenor” and “purport” of the original trust signifies the charitable purpose itself, a wider charitable purpose, or a much broader purpose, arise.

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<sup>134</sup> . The Japanese *Law of Trusts*, article 73; the South Korean *Law of Trusts*, article 72.

To answer these questions, the first thing is to determine the denotation of the term “tenor” or the term “purport”. It is thought that the denotation of the term “tenor” or “purport” used in a charitable trust has meanings at three-levels. The meaning at the highest level is the overarching charitable purpose, which can be directly inferred from the term “charitable trust”. The definition that a charitable trust means a trust for the promotion of charitable purpose itself signifies the trust is created for the charitable purpose or purposes. That is to say, since the trust is charitable, undoubtedly, the purpose of the trust is charitable.

The meaning at the intermediate level is the general charitable purpose, which can be classified according to the classification of the charitable trusts, such as the general charitable purpose for the relief of poverty, or the general charitable purpose for the advancement of education. The general charitable purpose at the intermediate level is the basis to apply the cy-pres doctrine. For example, if the original charitable purpose is to build a school in a small town and the purpose failed for the insufficiency of the trust fund, the trust fund can be applied to another purpose for the advancement of education by executing the cy-pres scheme. If the trust property was applied to a purpose for the advancement of religion, it would not be the application of cy-pres doctrine in that it violated the spirit of cy-pres, namely the principle of “as near as possible”.

The meaning at the lowest level is the specified charitable purpose laid down by the creator of the charitable trust. Because of some reasons, such as the change of circumstances, the specified purpose may be or become impossible to be carried out and the failure of the specified purpose results in the application of cy-pres doctrine. Although the specified charitable purpose is at the lowest level, it is the foundation of ascertaining the purposes at the intermediate and highest levels. It is the specified purpose that decides whether or not a trust is charitable trust and which category the

charitable trust belongs to. In other words, a specified charitable purpose embodies the general charitable purpose and the overarching general charitable purpose.

In the light of the meaning at the three levels, the tenor or the purport of the original charitable trust provided for by article 73 of the Japanese *Law of Trusts* and article 72 of the South Korean *Law of Trusts* means the charitable purpose at the intermediate level, namely the general charitable purpose. Thus, the tenor and purport of the original charitable trust under the Civil Law is in fact similar to the general charitable intention under the Common Law.

It is noteworthy that the provisions for the cy-pres of the *Law of Trusts* of Japan and South Korea are not the same as those of China and Taiwan. The *Law of Trusts* of Japan and South Korea requires that to apply the trust property to another charitable purpose which is similar to the original trust shall not violate the tenor and purport of the charitable trust, namely the general charitable purpose.<sup>135</sup> On the contrary, the *Law of Trusts* of China and Taiwan does not provide that the application of cy-pres shall not contravene the general charitable purpose of the trust, but provide for two alternative cy-pres schemes, namely to apply the trust property to a similar purpose or to transfer the trust property to another charitable organization or another charitable trust which has the similar charitable purpose to the failed original charitable purpose.<sup>136</sup>

However, although the *Law of Trusts* in China and Taiwan does not provide a general charitable purpose, it should be construed that the cy-pres doctrine should still be applied within the category of charitable purpose under which the original purpose belongs to, because the *Law of Trusts* in China and Taiwan provides that the trust

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<sup>135</sup> . The Japanese *Law of Trusts*, article 73; the South Korean *Law of Trusts*, article 72.

<sup>136</sup> . The Chinese *Law of Trusts*, article 72; the *Law of Trusts* of ROC, article 79.

property should be applied to another charitable purpose which is similar to the original one.<sup>137</sup>

In addition, it seems that it is redundant to provide for “transferring the trust property to another charitable organization or another charitable trust which is of the similar purpose”. No matter whether it is to apply the trust property to a similar purpose or to transfer it to another organization or trust which has the similar purpose, they are all nothing but specific methods of applying the cy-pres doctrine.

Moreover, unlike the *Law of Trusts* in Japan, South Korea and Taiwan, the Chinese *Law of Trusts* requires that the application of cy-pres scheme must be approved by the administrative office of charitable business.<sup>138</sup>

Viewing from article 72 of the Chinese *Law of Trusts*, the provisions on the application of cy-pres scheme, which almost borrow from that of the *Law of Trusts* of Taiwan, need to be improved. It is suggested that it should be better to provide for cy-pres scheme simply like this: “In cases where there is an initial or subsequent impossibility to carry out the charitable purpose of a trust, the trust property shall be applied to another purpose which is as near as possible to the original charitable purpose”.

#### **5.4.2.3 Variation of the terms of charitable trust and cy-pres**

All the above four Civil Law jurisdictions provide that in the case of the change of circumstances which could not be foreseen at the time when the charitable trust was created, the competent government office or administrative office of charitable

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<sup>137</sup> . The Chinese *Law of Trusts*, article 72; the *Law of Trusts* of ROC, article 79.

<sup>138</sup> . The Chinese *Law of Trusts*, article 72.

business is entitled to vary the terms of the trust without in breach of the tenor of the charitable trust. Article 69 of the Chinese *Law of Trusts* provides:<sup>139</sup>

Where special circumstances, which could not be foreseen at the time of creation of the charitable trust, have occurred after the charitable trust had been created, the administrative office may vary the relevant terms of the trust instrument in accordance with the object of the charitable trust.

According to article 9 of the Chinese *Law of Trusts*, the terms of the trust must be written in the trust instrument. To change relevant terms of a charitable trust by the administrative office means that such office may also change the terms of the specified charitable purpose so long as the change does not violate the tenor or object of the charitable trust. Where the administrative office varies the terms of the specified charitable purpose, the question as to whether the variation is or is not regarded as the application of cy-pres doctrine arises.

As discussed above, the term “tenor” or “purport” used by article 73 of the Japanese *Law of Trusts* and article 72 of the South Korean *Law of Trusts* represents the charitable purposes at three different levels, namely the overarching charitable purpose, the general charitable purpose, and the specified charitable purpose. In the light of the division of the charitable purposes at the three levels, the question as to whether or not the competent or administrative office modifies the terms of the original charitable purpose by applying a cy-pres scheme depends on where or not the competent or administrative office varies the terms of the specified charitable purpose within the same category of the general charitable purposes under which the modified charitable purpose belongs to. Where the competent or administrative office varies the terms of the specified charitable purpose within the same category of the general charitable purpose and the trust property is applied to another purpose as near as the

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<sup>139</sup>. See also the Japanese *Law of Trusts*, article 70; the South Korean *Law of Trusts*, article 67; the *Law of Trusts* of ROC, article 73.

original purpose within the same category, the variation, clearly, is the application of cy-pres doctrine. For example, a trust was created to eradicate a particular disease in a village, but the disease had been already eradicated before the trust was created. Thus, the terms of the specified purpose was modified to eradicate another disease.

In contrast, where the variation of the terms of the specified charitable purpose by the administrative office is outside the literal scope of the charitable purpose, the variation is not the application of a cy-pres scheme because the variation of the charitable purpose is still within the tenor or object of a charitable trust, namely the overarching purpose of charity. For example, the trust property to eradicate a particular disease was applied to another purpose for the advancement of education.

## **5.5 The Relationship between the Chinese Law of Charitable Donation and the Law of Trusts**

Before the enactment of the Chinese *Law of Trusts*, the Chinese *Law of Charitable Donation* was enacted on June 28, 1999 in the Tenth Session of the Standing Committee of the Ninth Chinese National People's Congress and has taken effect from September 1<sup>st</sup>, 1999. Because the purposes of charitable donations are the same as those of charitable trusts, the Chinese *Law of Trusts* is related to the Chinese *Law of Charitable Donation*. However, because the two *Laws* differ essentially from their nature, the application of the two *Laws*, practically, is of fundamental differences.

### **5.5.1 The Main Contents of the Chinese Law of Charitable Donation**

The Chinese *Law of Charitable Donation* comprises six chapters which have totally 32 articles. Chapter one, from article 1 to article 8, is General Provisions,

which provides for the aim and the range of the *Law*, the range of the charitable businesses, the nature of the donated property, and the State's attitude to charitable donations. Article 2 of the *Law* provides that "the *Law* shall be applied where individuals, legal persons or other organizations donate properties to social charitable organizations or non-profit public institutions for public benefits". Article 3 of the *Law* classifies the charitable businesses into the following four categories:

- (1) for the relief or assistance of sections of public and individuals who are in necessitous circumstances because of calamity, poverty or disability;
- (2) for the advancement of education, science, culture, hygiene, and sports;
- (3) for the protection of environment or the construction of public facilities;
- (4) for the advancement of other public businesses which can promote the social development and social progress.

With respect to the nature of the donated property, article 7 of the Chinese *Law of Charitable Donation* provides:

The property accepted as charitable donation by the social charitable organizations and the income of the donated property are social public property which are protected by the State and cannot be embezzled or damaged.

Chapter two, from article 9 to article 15, is Donation and the Acceptance of Donation, which provides mainly for the donor and donee, the methods of donation, and the donation contract. Article 9 of the *Law* provides that donors may be individuals, legal persons, or other organizations, while article 10 provides that only the social charitable organizations or non-profit institutions can be the donees. The social charitable organizations refer to the foundations or charitable organizations which are lawfully established for the advancement of charitable businesses,<sup>140</sup> such as China Youth Development Foundation, the Chinese Environmental Protection Foundation, China Foundation for Poverty Alleviation, and China Welfare

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<sup>140</sup> . The Chinese *Law of Charitable Donation*, article 10 (2).

Foundation for the Handicapped. The non-profit public institutions are reference to those lawfully established non-profit institutions of education, scientific research, medical care and hygiene, culture, sports, and social welfare,<sup>141</sup> such as schools, universities, hospitals, academic research institutes, and committees of culture and sports.

Chapter three, from article 16 to article 23, is Administration of Donated Property, which mainly provides that the donated property shall only be applied to charitable businesses. Where the donation is created by the contract, the donated property shall be applied to the charitable businesses in accordance with the intention of the donor.

Chapter four, from article 24 to article 27, is Preferential Measures, which provides that the donors can enjoy the advantages of the income tax if they donate properties to charitable businesses.

Chapter five, from article 28 to article 31, is Legal Liabilities, which provides for the legal liabilities for the violation of the *Law*.

Chapter six, article 32 alone, is Supplementary Provisions which provides for the date when the *Law* takes effect.

## **5.5.2 The Relationship between the Chinese Law of Trusts and the Chinese Law of Charitable Donation**

Although Chapter Six (“Charitable Trusts”) of the Chinese *Law of Trusts* and the Chinese *Law of Charitable Donation* have the same charitable purposes, they are different legal regimes. Generally, there are three major differences between the two legal systems

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<sup>141</sup> . Ibid, article 10 (3).

The first difference between the Chinese law of charitable trusts and the law of charitable donation concerns the identity of the trustee and the donee. Although article 62 of the Chinese *Law of Trusts* provides that the creation of charitable trusts and the appointment of the trustee or trustees shall be approved by the administrative office of charitable business, the range of trustee is not limited. Thus, so long as obtained the approval of the administrative office, either an individual or a legal person may be a trustee of a charitable trust. Whereas, the range of the donee of a charitable donation is limited to two kinds of legal persons, namely the lawfully established social charitable incorporates and non-profit charitable institutions.<sup>142</sup> In exceptional circumstances, the governments above county levels can act as the donees themselves. Article 11 (1) of the *Law of Charitable Donation* provides:

Where there is natural calamity or where the donor from overseas demand the governments above the county level or their departments of acting as the donee, the governments or their departments can accept donations and shall administer the donated properties in accordance with this Law.

Nevertheless, article 11 (2) of the *Law* also provides that the governments may either transfer the donation to social charitable organizations or non-profit institutions, or establish charitable business in accordance with the intention of the donor.

Secondly, public benefit is the chief requirement to create a charitable trust in China.<sup>143</sup> There is no characteristic of public benefit, and there is no charitable trust. However, according to article 3 (1) of the Chinese *Law of Charitable Donation*, a donation to individual can be also regarded as charitable donation. Thus, a donor can name certain individuals as beneficiaries when he/she donates property to a charitable organization or an institution. The different provisions by the *Law of Trusts* and the *Law of Charitable Donation* may cause the occurrence of the phenomenon that the

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<sup>142</sup> . The Chinese *Law of Charitable Donation*, article 2.

<sup>143</sup> . The Chinese *Law of Trusts*, article 60.

different consequences stem from the same act. For example, if a person creates a trust by delivering trust property to a charitable organization which holds the trust property for the purpose of assisting certain individuals, the trust is not a charitable trust because it lacks public benefit; while the person donates property to the same charitable organization for the assistance of the individuals, the donation is a valid charitable donation.

The provisions of article 3 (1) of the Chinese *Law of Charitable Donation* are not good law, because they violate the principle that a charitable purpose must exist for the public benefits. It is thought that the provisions of article 3 (1) of the *Law* might be a mistake which stems from some practical cases. For example, the China Youth Development Foundation has made a plan which is called “the project of hope”. The aim of the plan is to assist the children from poor families going to school. Where a person donates a sum of money to the Foundation, usually, the Foundation will give him/her a list of names of some children so that the donor may chose one or more of the children to assist according to the sum of the money he/she donates to the Foundation and the period he/she wishes to assist. Alternatively, the donor may not make such choice and simply donates money to the Foundation. But once he/she has made the choice, an assistance relationship is established between the donor and the child or the children he/she has chosen.

However, the establishment of such assistance relationship does not mean that the donor makes the donation particularly for these certain individuals in that the donor himself/herself does not name any specific individuals to be assisted. It is the Foundation which suggests the donor make a choice. Although the donor assists certain individuals after he/she made his/her choice, his/her donation is still regarded as charitable donation because he/she gives money to the certain students through the Foundation rather than giving to them directly. In addition, the aim that the

Foundation suggests the donor selecting certain individuals is to make the donor's donation meaningful, because, through the establishment of the assistance relationship, the donor can clearly know who he/she is assisting and can also encourage the beneficiary to study hard. Meanwhile, the beneficiary also knows who is his/her sponsor and may return the sponsor by studying hard.

Therefore, it is suggested that the term "individuals" should be deleted from the provisions of article 3 (1) of the Chinese *Law of Charitable Donation*.

Thirdly, under a trust, the ownership of the trust property is divided into the nominal ownership of the trustee and the substantial ownership of the beneficiary, while under a charitable donation, the provisions for ownership of the donated property stipulated by the Chinese *Law of Charitable Donation* are confusion. Article 7 of the *Law* provides merely that the properties and their income donated to the social charitable organizations belong to the public, but the *Law* does not provide for the nature of the properties donated to the non-profit charitable institutions. Thus, it is not clear whether the properties belong to the public or belong to the institutions themselves.

Because of the differences between the charitable trusts and the charitable donations, there may be some inconsistencies in the application of the two legal principles. In the future, the question whether the two laws shall be kept separate or be amalgamated will arise. It is suggested that in order to avoid the redundancy of the legal provisions concerning to the charitable businesses and to avoid the inconsistency between the two legal systems, it should be better to amalgamate them and use the charitable trust to absorb the charitable donation.

## PART TWO

# PERFECTING THE CHINESE LAW OF TRUSTS

The critically comparative study of the Australian and the Chinese law of trusts made in Part One of this thesis exposed the deficiencies in the Chinese *Law of Trusts*. Chapter 7 will, following on that comparative study, summarize the deficiencies in the Chinese *Law of Trusts*, analyse the reasons for the deficiencies, and propose remedies for improving the Chinese *Law of Trusts*.

In addition, although there are many deficiencies in the Chinese *Law of Trusts*, the enactment of the Chinese *Law of Trusts* significantly enriched Chinese property law. Specifically, the structure of the duality of ownership of the trust will be of practical significance in improving the Chinese State-owned enterprise reform. Thus, before discussing the perfecting of the Chinese *Law of Trusts*, Chapter 6 will discuss the practical impact of the Chinese *Law of Trusts* on State-owned enterprises in China.

## **Chapter 6**

# **The Practical Impact of the Chinese Law of Trusts on State-Owned Enterprises in China**

Although the Chinese *Law of Trusts* exhibits many deficiencies and needs to be improved, it is nevertheless an enactment of great significance in supplementing the Chinese ownership system, in introducing the basic concept of the trust into the *Regulations on the Management of the Trust and Investment Companies*, and in complementing the *Law of Charitable Donations*. However, the most immediate practical impact of the Chinese *Law of Trusts* is the improvement it has brought to the State-owned enterprises in China.

After the inauguration of the People's Republic of China in 1949, the economic system became a centrally planned economy, under which the supply of raw materials to State-owned enterprises, and the production and the sale of goods by State-owned enterprises, were all planned by the central government. The centrally planned economic system disclosed two defects: one in respect of economic efficiency, and the other in respect of the legal system. Economically, the enterprises had neither efficiency in production nor competitiveness in the sale of its products, because they produced goods in response to government directives and ignored the demands of the market. Legally, the owner of the assets in the State-owned enterprises was (and is) the State. The SOEs were not the owners of the property they possessed, nor were they legal persons which enjoyed civil rights and assumed civil liabilities independently of the State. They were simply the agents of the State and the State therefore bore unlimited liability for their losses.

From the end of the 1970s, China began to reform its economic system. The Chinese SOE reform has been a pivotal feature of this reform. The Chinese SOE

reform has focused on defining the property rights of the State and of the SOEs so as to make the SOEs into legal persons which can independently manage their affairs, enjoy civil rights and assume civil liabilities, and can be made responsible for their own profits and losses. Although the SOE reform has been carried out for more than two decades and has advanced the development of the Chinese economy, the fundamental problem, namely the ownership of assets problem in relation to SOEs, remains unsolved.

The ownership of assets problem of the SOEs derives from the traditional Chinese ownership system<sup>1</sup> which prohibits the existence of two ownerships over the same thing (the principle of one right to one thing) and regards the right of disposal as the essential element of ownership, whereby a non-owner is excluded from the right to dispose of a thing except where he/she has been authorized to do so by the owner. However, even in such a situation, the non-owner is merely acting as the agent of the owner and exercising the owner's right of disposal. In respect of a SOE, because it is not the owner of the State-owned assets, it can neither dispose of the assets independently of the authority of the State nor can it exclude the relevant government departments from interfering with its management. Consequently, the SOE cannot manage the State-owned assets efficiently and take responsibility for its own profits and losses. In respect of the State, it will not allow the SOE to have ownership of the State's assets for fear that once the State transfers the ownership of the assets to the SOE, the SOE will abuse its right of disposal to damage the interests of the State. Nevertheless, because the State is the owner of the trading assets in a SOE, the government department may abuse its right to interfere with the management of the SOE. Thus, while ensuring the protection of the State's interests, the need to ensure that a SOE is given sufficient property rights (ownership-like property rights) to

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<sup>1</sup> . See section 1.1.2 "the Definition of the Trust under the Civil Law" of this thesis.

manage the State-owned assets autonomously and efficiently and to exclude interference by the government departments has emerged as the central challenge of the Chinese SOE reform. With the progress of the Chinese SOE reform and the rapid development of the Chinese economy, the Communist Party of China has propounded two theories, which were later translated into law, in its attempt to solve the ownership problem of the assets of the SOEs. However, because of the limitations of the traditional Chinese property law theory, these attempts have failed to solve the fundamental ownership problem of the SOEs.

Fortunately, the enactment of the Chinese *Law of Trusts* offers the means to supplement and improve Chinese property law. The concept of the trust can be used to solve the ownership problem in the SOEs in the course of the Chinese SOE reform, and to advance the development of the Chinese economy. To understand fully the significance of the trust system in improving the SOEs reform in China, it is necessary first to look back on the history of the Chinese SOE reform, and to analyse the legal theories underpinning the different phases of the SOE reform.

## **6.1 The Different Phases in the SOE Reform and the Theories Which Inspired Them**

From the perspective of the property rights enjoyed by a SOE, the process of the Chinese SOEs reform is divided into the following three phases:<sup>2</sup> the phase of expanding the autonomous managerial rights of the SOEs; the phase of the separation of the rights of management from those of ownership; and the phase of defining a legal person's property rights.

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<sup>2</sup> . The division of the phases of the Chinese SOE reform differs between different scholars, especially between economic scholars and legal scholars. See Justin Yifu Lin, Fang Cai, & Zhou Li: *State-owned Enterprise Reform in China* (2001), pp 7 – 11.

## 6.1.1 The First Phase: Expanding the Autonomous Managerial Rights of SOEs (1979 – 1984)

The first phase, the phase of expanding the autonomous managerial rights of State-owned enterprises, began in 1978 when the Third Plenary Session of the Eleventh Central Committee of the Chinese Communist Party, which was a milestone in the economic reform in China, was held. That phase ended with the Third Plenary Session of the Twelfth Central Committee of the Chinese Communist Party which was held in October, 1984. The Third Plenary Session of Eleventh Central Committee of the CPC decided to vest in the State-owned enterprises more autonomous managerial rights.<sup>3</sup> For carrying out the spirit of the Third Plenary Session of the CPC, on July 13, 1979, the Chinese State Council issued the *Regulations concerning Expanding the Autonomous rights of Management and Administration of the State-Owned Industrial Enterprises*, which expanded certain autonomous managerial rights of those enterprises, such as the right of production and management, the right of sale of goods, the right of setting up offices, and the right of hiring employees. During this phase, the aim of the reform was to “gradually carry out the separation of the powers and functions between the government and the enterprises, and to expand the autonomous rights of enterprises in order to make the enterprises relatively independent socialist economic entities”.<sup>4</sup>

The reform during this phase changed, to some extent, the status of a SOE which formerly merely produced and sold goods strictly according to the dictates of the government. This reform enabled the SOEs to earn profits from the sales of its products, which have exceeded the projections made by the government. However,

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<sup>3</sup> The Communiqué of the Third Plenary Session of the eleventh Central Committee of the Chinese Communist Party.

<sup>4</sup> The Report on the Work of Government of the Fourth Session of the Fifth Chinese NPC.

because the centrally planned economic system was not changed during this phase of reform, and because the SOEs were only the agents of the State, the problem of ownership of the assets of SOEs did not then emerge.

The aim of the SOE reform in China is not only to promote the competitiveness and efficiency of the SOEs, but also to make the SOEs into independent legal persons which can enjoy civil rights and assume civil liabilities independently of the State. The first phase of the SOE reform which merely expanded the autonomous managerial rights of the SOEs did not achieve this goal, so it was followed by the second phase of SOE reform.

### **6.1.2 The Second Phase: the Separation of Rights of Management from Ownership (1984 – 1993)**

On October 20, 1984, the Third Plenary Session of the Twelfth Central Committee of the CPC promulgated *the Decision Concerning the Reform of the Economic System of the Central Committee of the Communist Party of China*, which stated:

According to the theory of Marxism and Leninism and the practice of socialism, the ownership and the rights of management can be separated properly... An enterprise shall become a relatively independent economical entity; become the socialist manufacturer and manager capable of managing and administering its affairs autonomously, and capable of being responsible for its profits and losses; and become the legal person who enjoys civil rights and assumes civil liabilities and be able to self-remake and self-develop.

The *Decision* required a SOE to become a relatively independent economic entity and a legal person which was capable of managing its affairs autonomously and which could enjoy civil rights and assume civil liabilities. To ensure that a SOE assumed civil liabilities independently, the *Decision* propounded the theory of the “separation of two rights” by explaining that “the rights of management can be

properly separated from ownership”. The essence of the separation of these two rights is that the State, as the owner of the trading assets, authorizes a SOE to manage those assets, and the SOE manages those assets merely as the agent of the State. This *Decision* constituted the second phase of the reform of the Chinese SOEs, a phase which lasted until 1993, and which was subdivided into the following two periods.

### **6.1.2.1 The two periods of SOE reform in the second phase**

The first period of the second phase of the Chinese SOE reform commenced with the issue of the DRES of CPC in 1984, and ended with the enactment of *the Law of the Industrial Enterprises under the Ownership of the Whole People of China* in 1988.

After the establishment of the separation of two rights in 1984, the Chinese State Council issued the *Decision on Deepening Enterprise Reform and Strengthening the Vigour of Enterprise* in December, 1986 to implement the separation of the rights of management from ownership. The *Decision* introduced the concept of the Contract Responsibility System for granting the SOEs adequate rights of management.<sup>5</sup> To standardize and implement the Contract Responsibility System, the Chinese State Council enacted the *Temporary Regulations on Contract Responsibility System of the Enterprises under the Ownership by the Whole People* on February 27, 1988. The principle of the Contract Responsibility System is to determine the profits distribution relationship between the State and an enterprise by fixing an amount of profits which the enterprise must return to the State. The enterprise can retain the surplus over these profits and must supplement the fixed profits if it failed to reach the amount of the

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<sup>5</sup> “Contract Responsibility System” means that the managers of an enterprise enter into a contract with the government, by which, the managers enjoy the rights of management, the right of hiring employees, the right of distribute profits with the government and bear the liability of mismanagement. The government shall not be allowed to interfere with the management of the managers. Usually, the managers of the contract are the former leaders of the enterprise, but other people can also enter into contracts with the government and become the managers if they are eligible for management and administration.

fixed profits.<sup>6</sup> The promisor is the SOE and the promisee is the relevant government department.<sup>7</sup>

In addition to the Contract Responsibility System which applied throughout to the large and medium-sized SOEs, the Lease System of the small SOEs, which was another method of practically separating the two rights, was carried out in China.<sup>8</sup> Three months after the enactment of the Chinese TRCRS, the Chinese State Council enacted the *Temporary Rules on the Lease System of the Small Enterprises under the Ownership by the Whole People* on May 18, 1988. Article 3 of the *Temporary Rules* provides:

The lease system within this law refers to the State, without changing the nature of the ownership of the whole people and according to the separation of two rights, authorizes the relevant government department as lessor to deliver the enterprise to lessee to manage within a limited time, while the lessee pays the rent to the lessor and manages the enterprise autonomously in accordance with the contractual provisions.

For consolidating the fruits of the “separation of the two rights”, the Chinese GPCL recognizes that the enterprises under the ownership of the whole people are legal persons<sup>9</sup> who assume the civil liability with the properties which they have been authorized by the State to trade with.<sup>10</sup> In addition, article 82 of the Chinese GPCL provides:

Enterprises under ownership by the whole people shall lawfully enjoy the rights of management over properties that the State has authorized them to administer and manage, and the rights of management shall be protected by the law.

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<sup>6</sup>. The Chinese TRCRS, article 5.

<sup>7</sup>. Ibid, article 14.

<sup>8</sup>. In 1988, the Planning Commission of the State Council issued *the Standard of dividing Large, Medium, and Small Enterprise*, which divides enterprises into the extra large, large, medium, and small enterprises according to several reference conditions, such as the production capacity, the value of the fixed assets. For example, according to *the Standard*, a steel enterprise that produces 60,000 to one million tons of steel annually is a large enterprise and a medium enterprise refers to an enterprise that produces 10,000 to 60,000 tons of steel annually. While a small steel enterprise can only produce less than 10,000 tons of steel.

<sup>9</sup>. The Chinese GPCL, article 41.

<sup>10</sup>. The Chinese GPCL, article 48.

According to Section One, “Ownership and Related Property Rights”, of Chapter Five of the Chinese GPCL, the rights of management are provided as a kind of property right derived from ownership. However, the contents of the rights of management were not defined clearly by the GPCL. For defining the rights of management and granting the enterprises more rights, the second period of the second phase of the separation of the two rights, which began in 1988 and ended in 1993, followed. The hallmark of the second period is the enactment of the *Law of the Industrial Enterprises under the Ownership of the Whole People of China*. The LIEOWP was enacted in the First Session of the Seventh Chinese NPC on April 13, 1988. The LIEOWP is still law in China.

Article 2 (2) of the Chinese LIEOWP provides:

The State has the ownership of the properties in enterprises and authorizes the enterprises to manage and administer the properties according to the principle of the separation of the rights of management from ownership. Enterprises have the right to possess, the right to use, and the right of disposal, in accordance with the law, of the properties which they are authorized by the government to manage.

As discussed in Chapter One of this thesis, in the light of the traditional Chinese property law, ownership comprises four dominative incidents: the right to possess, the right to use, the right to benefit, and the right of disposal. The right of disposal is the most important right of ownership, without which a person does not have ownership. Because article 2 (2) of the LIEOWP provides that the State has the ownership of the assets traded by the SOEs, the rights of management, which are derived from ownership and enjoyed by the SOEs, are defined as comprising the right to possess, the right to use, and the right of disposal “in compliance with the law”. The right to dispose of assets is mainly provided in article 24 and article 29 of the Chinese LIEOWP. For example, article 24 of the Chinese LIEOWP provides:

An enterprise has the right to sell its products, except where it is otherwise provided by the State Council.

Since the DRES of the CPC expounded that “ownership can be properly separated from the rights of management” and introduced the rights of management, the “separation of two rights” characterized the Chinese SOE reform for ten years.

### ***6.1.2.2 The deficiencies in the theory of the separation of two rights***

Before discussing the deficiencies in the separation of two rights, it is worth explaining that a State-owned enterprise is established by the State. A SOE which is established in accordance with the law is a legal person. Article 41 of the Chinese GPCL provides that a SOE “shall be qualified as a legal person when it has sufficient funds as stipulated by the state; has articles of association, and organization and premises; has the ability to independently bear civil liability; and has been approved and registered by the competent government department”.

A SOE assumes civil liabilities in respect of the assets with which the State authorizes it to trade. Article 48 of the GPCL provides that, a SOE, “as a legal person, shall bear civil liability with the assets that the State authorizes it to manage”. Also, article 2 (3) of the Chinese LIEWP provides that “a SOE acquires the qualification of a legal person in accordance with the law and bears civil liability with the assets that the State authorizes it to manage”.

It is noteworthy that a SOE referred to in the LIOWP only means an industrial SOE, while a SOE defined by the Chinese GPCL comprises all the SOEs which engage in all types of business, such as industrial, commercial, or service.

Because the SOEs are given the rights of management, which are separated from ownership, to manage the State-owned assets, there are two deficiencies in the theory of the separation of two rights.

First, the SOEs cannot manage the State-owned assets efficiently by virtue of their limited right of disposal, and they cannot exclude the government from interfering with their management.

According to article 82 of the Chinese GPCL and article 2 (2) of the Chinese LIEOWP, the State only authorizes its assets to be managed by the SOEs, so that the State retains ownership of these assets. Thus, the relationship between the State and the SOEs is in fact the principal-agent relationship. Since the SOEs are the agents of the State, they must exercise their rights within the authority given to them by the State (the principal). Although the Chinese LIEOWP clearly prescribes that the rights of management embody three incidents: the right to possess, the right to use, and the right to dispose of assets in accordance with the law,<sup>11</sup> the qualification “in accordance with the law” means that the SOE’s right of disposal is limited to that of an agent. Because the SOEs can only exercise a limited right of disposal rather than a free right of disposal like an owner does, they cannot adjust their managerial policy promptly in response to market fluctuations. Thus, they cannot manage the State-owned assets efficiently and competitively.

In addition to the limited right of disposal, although the SOEs are given the rights of management, they cannot exclude the government from interfering with their management, in that the State is the owner of the assets traded by the SOEs and the SOEs are merely the agents of the State. For example, article 55 of the LIOWP provides that the relevant government department is in charge of examining and approving construction projects, important technology reform projects and other

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<sup>11</sup>. Article 2 of the Chinese IEOWP.

projects. Also, such a department is also in charge of removing the managers and appointing new managers. Since the SOEs have neither the right to dispose of the State-owned assets freely, nor the right to exclude the government from interfering with their management of the State-owned assets, they cannot manage the assets efficiently.

Secondly, the SOEs cannot take responsibility for their own profits and losses. Both the Chinese GPCL and LIEOWP provide that a SOE is a legal person and both article 48 of the GPCL and article 2 (3) of the LIEOWP provide that a SOE shall assume civil liability in respect of the assets that the State authorizes it to manage. However, by virtue of lacking a sufficient right of disposal as well as being unable to exclude the government from interfering with its management, a SOE, inevitably, fails to take responsibility for its own profits and losses. Much worse, a SOE's lack of independence produces the dilemma that the more the State interferes with the management of a SOE, the more the SOE cannot be responsible for its losses; the more the SOE cannot be responsible for its losses, the more the State wants to interfere with the management of the SOE, and the more the State has to make up the losses of the SOE, notwithstanding the paradox that the State is not legally liable for the debts incurred by the SOE because, for the purpose only of incurring debts, the SOE is a legal person with independent civil liabilities in relation to the trading assets. Sometimes, even when a SOE is on the brink of bankruptcy, the State will not let it go bankrupt because of the imperfect social insurance system in China. The State has to make up the losses by financial subsidies in order to decrease the social pressures caused by the unemployment that would otherwise result.<sup>12</sup> Where a SOE cannot independently enjoy the civil rights and independently assume the civil liabilities in

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<sup>12</sup> . The State spent 25.881 billion RMB to make up the losses of the SOEs in 1998. See Yang Ruilong: *The Economic Analysis of the Managerial Structure of the State-owned Enterprises* (2001), p 20 and p 45.

relation to the trading assets, it is merely a nominally, rather than a substantively, independent legal person because of those restricted rights and liabilities.

By virtue of the deficiencies inherent in the theory of the separation of two rights, that theory was replaced by the theory of a legal person's property rights after the Chinese *Company Law*, enacted in 1993, precipitated the third phase of the Chinese SOE reform.

### **6.1.3 The Third Phase: A Legal Person's Property Rights (1993 – Present)**

On November 14, 1993, the Third Plenary Session of the Fourteenth Central Committee of CPC promulgated the *Decision of the Central Committee of the Communist Party of China on Issues Concerning Establishing the Socialist Market Economy*, which marked the beginning of the third phase of the Chinese SOE reform. This *Decision* indicated that the Chinese economic system had begun to move from a centrally planned economy to a socialist market economy. It prescribed that the company system be the guide of SOE reform, and propounded the theory of a legal person's property rights by stating:

It is expedient for the State-owned enterprises to attempt practising the company system. The standardized companies, which can achieve effectively the separation of the investors' ownership and the legal person's property rights of enterprises, is advantageous to the separation of the powers and functions between the government and the enterprises, to the transformation of the management system in order to make enterprises extricate themselves from reliance on the administrative departments of the government, and to make the State free from assuming unlimited liabilities for enterprises; and is advantageous to the collection funds and to the dispersal of risk ...The State shall take a further step to transform the management system of the State-owned enterprises and establish the modern enterprise system which can meet the demands of the market economy, has clear-cut property rights, has distinct powers

and responsibilities, can separate the powers and functions of the government and the enterprises, and has a scientific management system.

This *Decision* has three coherent aims: (i) to establish a modern enterprise system, namely the company system so as to drive the SOEs into the competitive market by transforming them into companies; (ii) to recognize that the SOEs each have a legal person's property rights in relation to the assets with which they trade, so that they are governed by the rules of the market, to strengthen the transformed SOEs, and to make them efficient and profitable contributors to economic growth and the welfare of society through market competition; (iii) to require the modern enterprises to have clear-cut property rights, distinct powers and responsibilities, and to achieve the separation of the powers and functions of the government and those of the enterprises, and have a scientific management system.

In order to confer a legal person's property rights on the SOEs, as had been proposed by the DESME, the Chinese *Company Law* was enacted on December 29, 1993. Article 2 and article 3 of the Chinese *Company Law* first provides that a company within the meaning of the *Law* is a limited company or a joint stock company, and a limited company as well as a joint stock company is a legal person.

Then, article 4 of the Chinese *Company Law* confirms that a company possesses a legal person's property rights, stating that "a company has a legal person's property rights to the whole assets contributed by the shareholders".

However, although the Chinese *Company Law* has confirmed "a legal person's property rights", it has not defined explicitly what a legal person's property rights are. The questions as to the nature of "a legal person's property rights", and the relationship between a company's property rights as a legal person and the rights of shareholders are still being debated.

### **6.1.3.1 The confusion caused by the Chinese Company Law**

In contrast to the rights of management which are separated from ownership, a legal person's property rights are independent rights enjoyed by a company and it is not separated from ownership. Article 4 of the Chinese *Company Law* provides:

- (1) A shareholder of a company, as a contributor of assets, enjoys the rights of an owner to the income of his/her contribution, to make important decisions, and to select management personnel.
- (2) A company has a legal person's property rights to the whole assets contributed by the shareholders, and enjoys the civil rights and assumes civil liabilities in accordance with the law.
- (3) The State has the ownership of its assets in a company.

Thus, according to article 4 (1) and (2) of the *Company Law*, once a company has been set up, the contributors of the company become the shareholders of the company. The assets they have given to the company become the assets of the company. The company, rather than the shareholders, is given the full property rights of a legal owner over the assets (contributions), while the shareholders have only the ownership of the income derived from his/her contribution (shares), the right to supervise the use and management of the assets, and the right to dispose of his/her shares, as opposed to the assets of the company. Being affirmed legally that a company has a legal person's property rights, it is hoped that the company can manage and administer its affairs independently according to the needs of the market, can be responsible for its own profits and losses, and will not be interfered with by the government, other organizations, or individuals. However, because article 4 (3) of the Chinese *Company Law* provides that "the State has ownership of its assets in a company", that *Law* has produced a literal inconsistency between article 4 (2) and article 4 (3), so that the theory of a legal person's property rights cannot solve the ownership problem of

assets in a SOE. Examining article 4 and other relevant articles of the Chinese *Company Law*, that *Company Law* has produced confusion in two areas.

#### **6.1.3.1.1 The creation of a distinction between State-owned companies and non-State-owned companies**

The Chinese *Company Law* has improperly created a distinction between State-owned companies and non-State-owned companies.

As a general principle, all companies have the same legal status since they are governed by the same company law. The Chinese *Company Law* should not have divided companies into State-owned companies and non-State-owned companies. With respect to the legislative technique, the State-owned companies should have been regulated by a special law, which means that the State-owned companies should have been removed from the ambit of the Chinese *Company Law*. However, in emphasizing the protection of the State-owned assets in a company, the Chinese *Company Law* has divided companies into State-owned Companies (SOCs) and non-State-owned companies (non-SOCs). For example, Section 3 of Chapter Two of the *Company Law* (article 64 to article 72) specifically deals with the sole-contributor State-owned companies.

In the light of the Chinese *Company Law*, clearly, there are two kinds of State-owned companies (SOCs): the State-owned limited companies and the State-owned joint stock companies. The State-owned limited company can be subdivided into the sole-contributor State-owned company and the State-owned limited company with two or more shareholders who are State authorized investment entities. Usually, a State authorized investment entity is a government department or institution in different regions or at different levels. In addition, a SOE is also a State authorized investment entity if it is authorized by the State to establish a subsidiary enterprise or

to establish another SOE with other State authorized investment entities. However, whereas a government department is an organ of the State and therefore acts as the State, a SOE is not an organ of the State, and merely acts for the State.

Article 20 (2) of the Chinese *Company Law* provides that “a State authorized investment entity or department may establish a sole-contributor state-owned limited liability companies as the sole contributor”. Article 64 of that *Law* defines a sole-contributor SOC as “established by a sole State investment entity authorized by the State”. Because the assets of a sole-contributor SOC are wholly owned by the State, the sole-contributor SOC does not own any assets. So, although a sole-contributor SOC possesses the shell of a company, it is only an agent of the State. Thus, some scholars have translated the sole-contributor SOC into “wholly State-owned company” in English.<sup>13</sup> However, this translation is too narrow. It overlooks the fact that the assets of a SOC which is established by two or more State authorized investment entities are also wholly owned by the State. For example, in the case where the Finance Department “A” in M Province and the Finance Department “B” in N Province establish a company, although “A” and “B” are State authorized investment entities representing different regions, both “A” and “B” are parts of the State organ and both of them personify the State. Thus, the assets they contributed as a whole belong to the State and the State is the sole contributor. Therefore, according to article 4 (3) of the *Company Law*, which provides the State-owned assets in a company belong to the State, the term “wholly State-owned companies” should be extended to the multiple contributor SOEs.

According to article 20 (1) of the Chinese *Company Law* which provides that: “a limited liability company shall be established by 2 or more, but not more than 50 shareholders”, and according to article 16 (2) of the *Law* which provides that a limited

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<sup>13</sup> . Wang Guiguo and Roman Tomasic: *China’s Company Law: An Annotation* (1994), p 67.

liability company established by two or more State authorized investment entities shall manage the company democratically in the form of worker's union, a limited company, which is established by two or more State authorized investment entities is still a State-owned limited company. According to article 4 (3) of the Chinese *Company Law* which provides: "The State has ownership of its assets in a company", although the assets of the SOC are divided into shares which are held by the different entities or SOEs, the assets as a whole of the SOC are still owned by the State in that the entities represent the State and the assets of SOEs, according to article 2 of the LIEOWP, are owned by the State. The division of shares only represents the contribution of different representatives and agents of the State, and it is convenient for the representatives and agents to transfer their shares. In essence, the sole-contributor limited SOCs and the multiple-contributor limited SOCs are the same because the assets of either type of SOCs are wholly owned by the State. The only difference is in the number of the shareholders (contributors). Although article 4 (3) of the Chinese *Company Law* is not good and creates much confusion, it represents the "national conditions" in China. Article 4 (3) is designed to protect State-owned assets from dissipation by SOCs.

It is difficult to envisage the assets of a stock joint company wholly owned by the State. However, the Chinese *Company Law* makes it possible for a joint stock company to be a SOC. According to article 74 the *Law*, a joint stock company may be established either by sponsorship or public share offer. The establishment by sponsorship means establishment of the company through subscription by the sponsors for all the shares to be issued by the company. Thus, according to articles 74 and 75 of the Chinese *Company Law*, so long as more than 5 sponsors of a company who are State authorized investment entities subscribe all the shares issued by the company, the company is a State-owned joint stock company.

Apart from the SOCs which are established directly by the State authorized investment entities, according to articles 7 and 21 (1) of the Chinese *Company Law*, a sole-contributor State owned company and a State owned limited company with two or more shareholders can be incorporated from the existing SOEs. Article 21 (1) of the *Company Law* provides:

A State-owned enterprise established prior to the coming into force of this Law may be transformed into a sole-contributor State-owned company if it is established by a sole State investment entity (institution), or a limited company if it is established by two or more State investment entity (institution), as provided for in paragraph one of the preceding article, in accordance with this Law, provided that the conditions required by this Law for the establishment of limited companies have been satisfied.

According to articles 74 and 75 of the Chinese *Company Law*, a SOE may also be transformed into a joint stock SOC, so long as there are more than 5 sponsors who are State authorized investment entities, whether these entities be government departments or SOEs. Before any of the shares of the joint stock SOC are transferred to private shareholders, according to article 4 of the *Company Law*, all the assets are still owned by the State. However, usually, where a SOE is transformed into a joint stock company, it will not be transformed into a complete SOC of which all the shares are owned by the State. The State will only control a majority of shares of the transformed joint stock company. Thus, some scholars have suggested that, according to the *Temporary Rules on Administration of the State-owned Share Rights of Joint Stock Companies*,<sup>14</sup> a SOC is a company in which the State controls more than 50% shares of the company, or a company in which the shares of the company are

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<sup>14</sup>. Article 11 of the *Temporary Rules on Administration of the State-Owned Share Rights in Joint Stock Companies* (1994) provides that where a SOE is to be transformed into a joint stock company, the State's status of controlling share rights shall be secured. The status of controlling share rights by the State is divided into absolute control, which means the State controls more than 50% shares of a joint stock company, and relatively control, which means the State controls more than 30% and less than 50% of the shares of a joint stock company where the shares are dispersive.

variously owned and the State controls more than 30% of the shares.<sup>15</sup> This suggestion is not convincing, because article 11 of *the Temporary Rules* does not mean that a joint stock company is a SOC so long as more than 50% shares or more than 30% dominative shares of the company are controlled by the State. The spirit of this article is to secure the dominative status of the State to the companies transformed from the SOEs so as to protect the State-owned assets from dissipation. In addition, no matter how many shares the State owns in a company, the company is not a complete SOC so long as there are shares that are owned by private shareholders. According to article 4 (3) of the Chinese *Company Law*, the State has ownership of the assets in a company, but the State cannot have ownership of the assets contributed by other shareholders to the company. Since there are private shareholders in a company, the company cannot be called a SOC.

#### **6.1.3.1.2 The confusion caused by article 4 (3)**

Because article 4 (3) of the Chinese *Company Law* provides that “the State has ownership of its assets in a company”, the *Law* has introduced inequality of status between the shareholders, confused the capital structure of a company, and broken the general rule that any investment under a market economy may bring benefits as well as risks.

It is an entrenched principle of company law that a shareholder has ownership of his/her shares, and a company has ownership of all of its assets. According to article 4 (1) and (2) of the Chinese *Company Law*, a shareholder, as a contributor, enjoys the rights of an owner to the income of his/her contribution, to make important decisions, and to selecting management personnel, while a company enjoys the property rights of a legal person to the whole of the assets invested by the shareholders. Thus, a

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<sup>15</sup>. Shi Jichun: *On State-Owned Enterprises* (1997), pp 12 to 14; Chen Hehong, Liu Zhihui, & Wang Honglian: *Studies on State-Owned Share Rights* (2000), p 206.

shareholder's rights are based on the footing that he/she is the owner of its contribution (the shares), because a company has ownership of all its assets. However, article 4 (3) of the Chinese *Company Law* has disrupted this fundamental principle of company law by providing that "the State has ownership over its assets in a company". In respect of a non-SOC, where the State is only one of several shareholders, the provision of the article 4 (3) creates inequality of legal status between the State and the non-State shareholders, in that the State is not only the owner of its shares, but is also the owner of the assets it invested in the company,<sup>16</sup> whereas private shareholders are only the owners of their shares.

Also, article 4 (3) has confounded the capital structure of the company, because whereas the company does have ownership of the assets contributed by the private investors, the company does not have ownership of the assets contributed, i.e. owned, by the State. Anomalously, the rights of the company as a legal person are divided into: (i) a legal person's property rights in relation to the assets contributed by the State, which do not include the ownership of those assets by the company; and (ii) a legal person's property rights in relation to the assets contributed by private shareholders, which do include the ownership of those assets by the company.

In addition, article 4 (3) of the Chinese *Company Law* breaks the risk rule of investment. According to article 4 (3), the State has ownership of its assets in a company, so the ownership of those assets has not been transferred to the company. Thus, the assets owned by the State cannot be listed as liquidation assets and the State is entitled to retain them when the company goes bankrupt. The fact that the State bears no risks and only enjoys the benefits of the investment violates the principle of risk investment in a market economy.

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<sup>16</sup> . Theoretically, it cannot determine what assets in a company belong to the State and what assets belong to other shareholders except for the fixed assets. Thus, article 4 (3) of the Chinese *Company Law* cannot be of full practical significance.

The provision of article 4 (3) of the Chinese *Company Law* may be the real reason why a company cannot have ownership of all its assets and is only given a legal person's property rights. Because of the uncertainty of the term "a legal person's property rights", the nature of a legal person's property rights has been discussed extensively both in the legal and the economical circles in China ever since that term was introduced.

### **6.1.3.2 The discussion of the nature of a legal person's property rights**

There are three theories of the nature of the legal person's property rights. The first theory is that the legal person's property rights are ownership. This theory can be subdivided into the theory of single ownership, which suggests that a legal person's property rights means that a company has ownership of its assets, and the shareholders have only the share rights;<sup>17</sup> and the theory of dual ownership, which suggests that both the shareholders and the company have rights of ownership, since article 4 (3) of the Chinese *Company Law* clearly provides that the State has the ownership of its assets which the State contributes to a company.

The scholars who support the theory of dual ownership differ in their respective explanations of that concept. Some of these scholars<sup>18</sup> think that a legal person's property rights include property ownership, intellectual property rights, and the rights of obligations. The legal person's property rights as a whole are restricted by the ownership of the shareholders, and the company cannot, in the name of an owner, act against the will of the whole body of shareholders. Some of them, mainly economic

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<sup>17</sup>. Kong Qiangjun: "On Structure of Property Rights of Modern Companies – a commentary on the provisions of our Company Law relating to the property rights of companies", *Forum on Politic Science and Law*, Volume 4, 1994, pp 31-34.

Yang Qinghe: *Modern Enterprise Rights System* (1994), pp 30-31.

Chen Hehong, Liu Zhihui, & Wang Hongliang: *Studies on State Share Rights* (2000), p 100.

<sup>18</sup>. Jiang Ping: *The New Textbook of Company Law* (1994), p 76.

scholars,<sup>19</sup> think that both the State and the company have the ownership of the assets in a company, but the ownership of the State is called the ultimate ownership because the ultimate fate of a company is determined by the shareholders. Some of them<sup>20</sup> consider that the shareholders have the ownership of the company itself and the company has the ownership of its assets. The shareholders do not directly have the ownership of the company's assets. The structure of dual ownership is the exception to the "one right to one thing" principle of the property law. This view is supplemented by describing the ownership of the shareholders as the nominal ownership of shareholders and the ownership of the company as the functional ownership of the company which arises where the company performs its function.<sup>21</sup>

The second theory which has been suggested by some economic scholars is the theory of combination. The scholars<sup>22</sup> think that a legal person's property rights are rights by which a company independently dominates the properties which it is authorized by the State to use. A legal person's property rights are the combination of the rights of management and the system of legal person. It is the combination of the rights of management and the system of the legal person that creates the legal person's property rights. The rights of management are different from a legal person's property rights. The former derives from ownership, but the latter stems from the combination of the rights of management and the system of the legal person.

Some scholars have suggested a third explanation, the theory of the rights of management. They regard a legal person's property rights as still the rights of management. They think that a company has only the rights of management over its

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<sup>19</sup>. Zhou Shuliang: "Problems Concerning the Property Rights of the SOEs", Volume 7 of the Chinese *Industrial Economy Research*, p. 4.

<sup>20</sup>. Wang Liming: *On Real Rights* (1998), p 505.

<sup>21</sup>. Wang Weiguo: "The Legal Analysis on Property Rights", Volume 3 of the *Collectives of Articles on Commercial Law* (1999), p 37.

<sup>22</sup>. Gao Shangquan: "Modern Enterprise System Is the Basic System of the Socialist Market Economy", volume 1 of the *Reformation* (1994), p 10. Hong Hu: "The Thinking of the Legal Person's Property Rights", Volume 1 of the Chinese *Industrial Economy* (1997), p 7.

assets, and the ownership of the assets belongs to the contributors of the company.<sup>23</sup> Jiang Ping, one of the drafters of the Chinese *Company Law*, had supported the view before he shifted to support the theory of the dual ownership. He thought, judging from the provisions of article 4 of the Chinese *Company Law*, that a legal person's property rights shall be deemed as the rights of management.<sup>24</sup>

However, none of the above theories of a legal person's property rights adequately expounds the nature of a legal person's property rights, because they have attempted to explain it by using the traditional theory of ownership under the Civil Law system. These theories are so awry that they are conceptually fragile. As far as the theory of single ownership is concerned, to deny the shareholders' ownership can neither explain the shareholders' right to decide the ultimate fate of the company nor explain the shareholders' right to the residual properties of the company which will be returned to them when the company goes bankrupt.

In respect of the theory of the dual ownership, if both the shareholders and the company have ownership of the assets of the company, it certainly violates the "one right to one thing" principle of the civil law on the one hand; and on the other hand, when there is a conflict between the two ownerships, it cannot distinguish which one is to prevail. Also, the view that the shareholders have the ownership of the company itself and the company has the ownership of its assets tries hard to avoid mentioning the shareholders have the ownership of the assets, but it still cannot clarify that why the shareholders cannot have the ownership over the assets of the company since the shareholders have the ownership of the company itself. Importantly, since a company is a legal person, it is independent legally and cannot be owned like a slave.

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<sup>23</sup>. Yu Lunbin and Li Guoqing: "Analysis on the Legal Nature of the Property Rights of the SOEs", Volume 5 of Chinese *Legal Science* (1994), pp 85-87.

<sup>24</sup>. Jiang Ping: *The Principles and the Application of the Chinese Company Law* (1993), pp 141-142.

Again, to divide the ownership into the nominal ownership of shareholders and the functional ownership of company, in fact, does not explain who has the essential ownership, and why the ownership of shareholders is only nominal since the shareholders have the ultimate right to decide the fate of the company.

The theory of combination suggests that it is the combination of the rights of management and the system of legal person that creates the legal person's property rights, but it does not answer the question why only the companies have a legal person's property rights with such combination and why the enterprises, which have not been transformed into companies, have only the rights of management rather than a legal person's property right, although they are also the legal persons with the combination of the rights of management and the system of legal person.

Similarly, the theory of the rights of management cannot explain why the Chinese *Company Law* uses a different concept, "a legal person's property rights", to replace the concept of the rights of management since they are exactly the same. If a company has only the rights of management and has no ownership of its assets, it does not need to require the SOEs be transformed into companies.

### **6.1.3.3 *The deficiencies in the theory of a legal person's property rights***

From the arguments on the nature of a company's legal person's property rights, two deficiencies in the theory of the legal person's property rights arise. First, under the theory, a company has not obtained the rights greater than the rights of management provided for by the Chinese LIEOWP. Since the State, according to article 4 (3) of the Chinese *Company Law*, has ownership of its assets in a company, the company, as a non-owner, does not have the independent right to dispose of the

State-owned assets. For example, article 71 of this law provides that the transfer of the assets of the sole-contributor SOE shall be approved by the State, which reads:

Where a sole-contributor State-owned company transfers its assets, the investment institution or department authorized by the State shall undertake the procedures for examination, approval, and transfer of property rights, pursuant to the law and administrative regulation.

Similarly, with respect to a SOC with two or more shareholders, although the assets of the SOC are divided into shares and owned by different shareholders, the assets are still owned by the State because the different shareholders are different State authorized entities, which represent the State. Since a SOC with two or more shareholders still cannot own any assets, it is nothing more than an agent of the State. So, it cannot dispose of the State-owned assets owner, but only as the agent of the owner.

In respect of a non-SOC, where the State is only one of the shareholders, the right of disposal enjoyed by the company is also limited because the assets of such a non-SOC are partially owned by the State. Since a company cannot dispose of the State-owned assets as an owner does, it is cannot said that a legal person's property rights are greater than the rights of management.

Secondly, the phrase "legal person's property rights" is so ambiguous that it is understood variously by directors and managers of companies. In practice, a legal person's property rights may drive a company to two extremes. The company, on the one hand, may dispose of the assets of the State improperly, either inadvertently or even intentionally, resulting in loss of the State assets; on the other hand, the company cannot effectively adjust its management strategy in time and dispose of the assets of the State properly because of the interventions from the government.

The deficiencies in the theory of a legal person's property rights have shown that the SOE reform in China has been less than successful. Notionally, the theory of the

legal person's property rights has replaced the leading role of the theory of the separation of two rights, namely the separation of the rights of management from ownership, but it has not completely superseded the latter. The two theories coexist. At present, in China, SOCs are governed by the Chinese *Company Law*, while SOEs which have not been transformed into companies are still governed by the Chinese LIEOWP and the Chinese GPCL. In practice, the theory has not made SOCs much more effective and competitive than SOEs, in that the directors and other management personnel of the companies were usually the directors and the management personnel of the former SOEs. In SOCs, the directors and other management personnel are usually appointed, assigned, or replaced directly by a department of the CPC and the government.<sup>25</sup> Because the personal interests of the management personnel have nothing to do with their management, they do not care much about whether they manage a company successfully or not. Meanwhile, they are still used to manage a company by old methods, so the company will not be successful without changing the old management ideology. According to the statistics of the Chinese Statistic Bureau, the following table <sup>26</sup> shows that since the enactment of the Chinese *Company Law*, the profits of the Chinese State-owned industrial enterprises and companies have decreased while the losses have increased.

Table 2: The profits and losses of the SOEs and State-owned companies					
[Counting unit: billion Chinese yuan (RMB)]					
Years	1993	1994	1995	1996	1997
Profits	81.726	82.901	66.560	41.264	42.783
Losses	45.264	48.259	63.957	79.068	83.095

<sup>25</sup>. The Chinese *Company Law*, article 68

<sup>26</sup>. The resources of the table come from the Chinese *Statistic Year Books* from 1993 to 1997.

Without a reasonable and convincing theory and with so many problems still besetting the Chinese SOEs, China also strove to find other theories to solve the fundamental ownership problem of the assets of SOEs (or SOCs). For example, On September 22, 1999, the Fourth Plenary Session of the Fifteenth Central Committee of the CPC promulgated *the Decision on Important Issues Concerning the Reform and the Development of the State-Owned Enterprises in China*, which propounded the theory of corporate governance structure. The *Decision* stated that the corporate governance structure is the core of the company system. However, the theory of corporate governance is essentially a theory of improving the management of a company rather than a theory of the nature of the legal rights of a company and of its contributors, so it cannot solve the problem of the State-owned assets in SOEs.

In addition, on October 14, 2003, the CPC introduced the requirement of improving the authorized management system by promulgating its *Decision on Issues Concerning Perfecting of the Socialist Market Economy* in the Third Plenary Session of the Sixteenth Central Committee of the Chinese Communist Party. In essence, the authorized management system is merely another way of describing the separation of two rights. It means that the relevant government institutions authorize SOEs to manage the state-owned assets on behalf the State. Under the authorized management system, the SOEs still enjoy the rights of management which are separated from state-ownership of the trading assets.

Since the theories of “the separation of two rights” and “a legal person’s property rights” have failed to achieve the aim of the SOE reform in China both from the theoretical and practical aspects, it is the time for China to shift its way of thinking away from the traditional ownership theory of the Civil Law so as to find a new theory to underpin the Chinese SOE.

## **6.2 The Trust: the Most Efficient Instrument for Administering and Managing the State-owned Assets**

After the enactment of the Chinese Law of Trusts in April 2001, it has become practicable for China to apply the concept of the trust to solve the ownership problems of the assets held by SOEs. Although the functions of the trust have been ignored by policy-makers and law-makers in China, so far, the trust system is the best and most efficient machinery to solve the ownership problem in relation to the assets traded by the SOEs. To adopt the trust system in substitution for the company system in administering and managing the State-owned assets, the bewilderment caused by the application of the company system will be eradicated.

### **6.2.1 The Application of the Trust to the SOEs**

To apply the trust to the SOEs to administer the State-owned assets will solve the ownership problem of such assets in SOEs and improve the SOE reform in China. Before discussing the application of the trust to the SOEs, it is first necessary to distinguish two kinds of SOEs.

#### **6.2.1.1 *The two types of SOEs***

According to the DESME of the CPC in 1993, which stated that “it is an expedient attempt for the SOEs practising company system”, and the DCRDSOE of the CPC in 1999, which requires that “a perfect modern enterprise system must be established by the end of 2010” and that “the large-scale and medium SOEs shall transform into company system”, in practice, many of the State-owned companies are transformed from former State-owned enterprises. A SOE may be transformed into either a sole-contributor SOC or a SOC with two or more shareholders, all of which

must be authorized State investment entities.<sup>27</sup> In addition, according to article 75 of the Chinese Company Law, a SOE may be also transformed into a joint stock limited company. Thus, in China, the SOEs are divided into two types: the incorporated SOEs, namely SOCs, and the unincorporated SOEs.<sup>28</sup>

In the light of article 41 of Chinese GPCL, article 2 of the LIEOWP, and article 3 of the Chinese *Company Law*, both the unincorporated SOEs and the incorporated SOCs are legal persons. Also, according to article 2 (2) of the LIEOWP and article 4 (3) of the *Company Law*, both the SOEs and the SOCs have no ownership of any assets, because the assets they administer and manage are wholly owned by the State. However, the unincorporated SOEs and the incorporated SOCs differ in some aspects. First, they are governed by different laws. A SOC is governed by the *Company Law*; an industrial SOE is governed by the Chinese LIEOWP; and a non-industrial SOE is governed by the Chinese GPCL. In addition, the unincorporated SOEs have the rights of management which are separated from ownership and assume civil liability with the assets with which the State has authorized them to trade, while the incorporated SOCs have a legal person's property rights and assumes civil liability with all its assets.

### **6.3.1.2 The application of the trust to the SOEs**

No matter whether it is an incorporated SOC or an unincorporated SOE, if such a SOC or SOE is established by one State authorized investment entity (which may be either a government department or another SOE), it is a sole-contributor SOC or SOE. If it is established by two or more State investment entities, it is a multiple-contributor SOC or SOE. Thus, the modes of the application of the theory of the trust differ as

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<sup>27</sup> . The Chinese *Company Law*, article 21.

<sup>28</sup> . It seems that the unincorporated SOEs and the incorporated SOEs are similar to the statutory Government Owned Corporations (GOCs) and company Government Owned Corporations (GOCs) provided for by section 7 of the *Government Owned Corporations Act 1993* (Qld).

between the two kinds of State-owned enterprises. It is noteworthy that the logical extension of the term “enterprise” is wider than that of “company” in Chinese laws. For example, article 3 of the Chinese *Company Law* regards a company as an “enterprise legal person”. Thus, when the SOE or SOEs are referred to in the following part of the text, it includes both the incorporated SOC or SOCs and the unincorporated SOE or SOEs, except where it is otherwise indicated.

Where a sole-contributor SOE is established by a State authorized investment entity which happens to be a government department, the department will transfer the State-owned assets to the SOE which will then hold the assets on trust for the benefit of the State. In this case, the State, personified by its authorized department, is the settlor as well as the sole beneficiary, and the SOE is the trustee.

However, where a sole-contributor SOE is established by another SOE (as opposed to a government department), such as a parent company and its subsidiary company, it can be deemed that the parent SOE, as trustee, and with the authority of the State as the sole beneficiary, transfers the assets beneficially owned by the State to the subsidiary SOE which holds the assets on a new trust for the benefit of the State. In this case, because the parent SOE was itself the original trustee for the State, the State is the settlor as well as the beneficiary, and the subsidiary SOE is the trustee. The State, as sole beneficiary of the assets, has resettled those assets on a new trust with the subsidiary SOE as the new trustee in substitution for the parent SOE (the former trustee).

In respect of a SOE that is established by two or more State authorized government departments, the State as personified by the government departments is the settlor as well as the beneficiary, and the SOE is the trustee. In the case where the SOE is established by two or more other SOEs, because the SOEs are the original

trustees of the assets for the State, similarly, the State is the settlor as well as the beneficiary, and the SOE is the new trustee.

Where a SOE is invested with the legal title to State-owned assets, it holds the assets on trust for the beneficial enjoyment of the State, so that a trust is thereby created. Once the trust relationship between the State and a SOE is established, the duality of ownership arises. The State has the beneficial ownership of the assets in the SOE and the SOE has the legal ownership of its assets. The rights and duties of the SOE and the State will then be regulated by the law of trusts. Thus, because of the duality of ownership, the trust reconciles article 4 (2), which provides that “a company shall have the entire property rights of a legal person over its assets contributed by the shareholders”, with article 4 (3), which provides that “the State has ownership of its assets in a company”, of the Chinese *Company Law*. Whereas article 4 (2) refers to the legal ownership of the company, article 4 (3) refers to the beneficial ownership of the State.

To distinguish beneficial ownership and legal ownership from the terminology of ownership used in other Chinese laws and regulations, the beneficiary’s ownership can be still called the “beneficial ownership”, and the trustee’s ownership can be also simply called “trustee’s ownership”.

### **6.3.1.3 The significance of the application of the trust concept to the assets traded by the SOEs**

So far, it has been suggested that applying the trust concept to solve the problem of ownership of the trading assets of the SOEs in China is advantageous and profoundly significant. First, the application of the law of trusts theoretically solves the problem of the duality of ownership which the traditional theory of ownership of the Civil Law cannot solve. The radical aim of the Chinese SOE reform is to protect

the State's status as owner of its assets and to ensure that a SOE manages and disposes of the State-owned properties in a way that an owner does. Looking at the course of the Chinese SOE reform, the theories informing the reform failed to achieve this aim, because they lost sight of the rights of a SOE when they focused attention on the State's status as an owner.

In respect of a trust, the special structure of the duality of ownership can not only ensure that the State has the beneficial ownership of the trust assets, but also ensures that the SOE has the legal ownership, namely the "trustee's ownership". The SOE exercises the "trustee's ownership" for the realization of the State's beneficial ownership rather than for the SOE's own benefit, otherwise, the SOE will be acting in breach of trust. The application of trust principles breaks through the "one right to one thing" principle of the traditional Chinese theory of ownership as well as solves the ownership problem in relation to the State-owned assets between the State and the SOEs.

Secondly, the trust makes it more convenient and effective for the State to monitor and control the trust properties. The trust concept enables the State to monitor a SOE effectively so as to make it manage and dispose of the State-owned assets for the benefit of the State and to protect the State-owned assets from being stripped off by the SOE. At present, the State has no effective system of monitoring the SOEs on their management and disposal of the State-owned properties. In the course of exercising monitoring and controlling rights, the State either monitors and controls the SOEs excessively which results in frequent governmental interferences with the management of the SOEs, or, alternatively, it weakens its monitoring role by only exercising a shareholder's rights in the shareholders' general meetings by accepting the view that the SOE has the ownership of the assets and that the State has only a shareholder's rights.

Where a trust is established between the State (the settlor as well as the sole beneficiary) and a SOE (the trustee), the duties of the trustee, as provided for in the trust instrument and by the law of trusts gives the State the right to monitor the SOE in that the trustee (the SOE) is placed under an obligation to keep and render proper accounts and to inform the beneficiary of matters relevant to its interests. Furthermore, the State, as the settlor, can reserve, in the trust instrument, necessary rights to monitor and control the management of the trust properties held by the SOE.

Thirdly, the “trustee’s ownership” of a SOE is sufficiently guaranteed. Since the SOE reform in China has given the SOEs independent civil rights, the nature of those rights have become the core problem for the reform. In the light of the provision that the State has the ownership to its assets in a SOE,<sup>29</sup> the SOE has no ownership of any item of State-owned property. Consequently and inevitably, as the owner, the State would interfere with the management of affairs by the SOE in various ways. However, the application of the trust concept ensures that the SOE has the rights of a trustee. Crucially, the notion that the SOE is a trustee of the assets for the State would reconcile article 4 (2) and article 4 (3) of the Chinese *Company Law*, in that whereas the SOC has the legal ownership of the assets [art. 4 (2)], the State has the beneficial ownership of the assets [art. 4 (3)].

Where the State vests its assets in a SOE which manages and disposes of the assets on trust for the benefit of the State, the SOE has extensive powers conferred by the trust instrument and the law in relation to dealing with the trust assets. The powers conferred on the SOE enable it to manage and to dispose of the trust assets, whilst recognising the beneficiary’s “beneficial ownership”. The rights and powers of the trustee (the SOE) will not be interfered with by the State so long as the SOE exercises trustee’s powers for the trust purposes in compliance with the terms of the trust

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<sup>29</sup>. The Chinese *Company Law*, article 4 (3).

instrument and the provisions of the law, unless the State elects to terminate the trust. Compared with the rights of management or a legal person's property rights, only the "trustee's ownership" can exclude the State (government departments) from interfering with the management affairs of a SOE.

### **6.3.2 The Application of the Trust to the Non-SOCs**

The trust can be applied not only to solve the ownership problems of the State-owned assets in SOEs and SOC, but also to administer and manage the State-owned assets in non-SOCs. Logically, the provisions of article 4 (3) of the Chinese *Company Law* are circular because that sub-article states that what belongs to the State in a company belongs to the State. In addition, in respect of a SOC, the provision is redundant since all the assets of the company belong to the State. The main legislative purpose of this sub-article is to emphasize that the State has the ownership of its assets in a non-SOC.

As discussed above, in the case of the coexistence of the State and non-state private shareholders in a company, the provision that "the State has the ownership of its properties in a company" will prejudice the interests of the private shareholders and unavoidably cause much confusion. Unfortunately, at present, there is no theory in China to explain satisfactorily why the State has the ownership of the assets which it has contributed to a non-SOC and why other, non-State, shareholders have no ownership of the assets which they contributed to the company, since the legal status of all of the shareholders' rights should uniformly not extend to ownership of the company's assets. As a matter of fact, there is no theory that can explain and solve the problem, because once the State has established a company together with private investors, its status as the owner of its assets should have been replaced by the status of a shareholder of the company, and the State should have no ownership of the assets

because they have been capitalized. What the State has should be only the share rights or the ownership of its shares in the company. However, by applying the trust device to the State-owned assets in non-SOCs, these problems will be solved.

In respect of the State-owned assets invested into a non-SOC, the assets may be invested into a non-SOC either by a SOE (or SOC) or by a State authorized government department.

There are two methods for a SOE (or SOC) to invest the State-owned assets into a non-SOC. The first and direct way is to buy the shares of a non-SOC. The second method of investment is to establish a non-SOC together with private company sponsors. Where the assets beneficially owned by the State are invested into a non-SOC by a SOE (or SOC), the investment act of the SOE (or SOC) can be deemed as the result of exercising the trustee's investment power and the SOE (or SOC) holds the shares of the non-SOC on trust for the benefit of the State. The shares of the non-SOC held by the SOE (or SOC) are still assets of the trust established between the State (the beneficiary) and the SOE (or SOC), the trustee.

In addition to exercising its investment power, a SOC may, for the purpose of effective management and in accordance with the trust terms, exercise its trustee's power to transfer its shares to private investors. After the transfer has been effected, the SOC ceases to be a SOC and becomes a non-SOC because some of its shares have been owned by private shareholders. In this case, the new non-SOC is still the trustee of the State-owned shares which have not been transferred to the private investors and the proceeds of the transfer of the State-owned shares. However, a SOC must act in accordance with the purpose of the trust and the terms of the trust instrument when it transfers its shares to private shareholders, or the transfer will breach the trust and will be voidable.

Theoretically, the State itself cannot administer and manage its assets, so the administration and management have to be entrusted to its organs, namely the government departments in different regions and at various levels. A government department, with the authority of the State, may invest the State-owned assets in non-SOCs by buying the shares of non-SOCs or by establishing non-SOCs together with other private company sponsors. However, because a government department, as an organ of the State, is usually an administrative institution, such as an administration committee of the State-owned assets, rather than a professional company, it cannot effectively administer and manage the State-owned assets in non-SOCs. For administering and managing the State-owned assets efficiently, the State can apply the trust device to achieve that goal.

The State can, through an authorized government department, transfers its assets in non-SOCs to a professional company to create a trust. The professional company holds the assets on trust for the beneficial enjoyment of the State. The State, represented by the government department, is the settlor as well as the sole beneficiary, and the professional company is the trustee. The professional company can manage and dispose of the trust properties according to the quotations of the market so as to maximize profits for the State. The management and the disposal of the State-owned assets by a professional non-SOC will be much more effective than that which can be done by a government department.

In China, there are such professional companies, namely, the trust and investment companies. Article 2 of the *Regulations on Management of the Trust and Investment Companies*, which was issued by the Chinese People's Bank in January 2001, provides that a trust and investment company can be a trustee to hold properties on trust for the benefit of others. It is noteworthy that a professional company may or

may not be a SOC. If the State thinks that it is necessary, a professional SOC can be established to manage and dispose of the State-owned assets in non-SOCs as a trustee.

In conclusion, to apply the trust system to the administration and management of the State-owned assets in SOEs and non-SOCs provides two safeguards. On the one hand, the State can reserve rights in the trust instrument to protect its interests if it thinks fit; on the other hand, the State can protect its interests by controlling the shares of the companies. More importantly, as the trust properties, the State-owned assets can be protected effectively by the Chinese *Law of Trusts* rather than by the Chinese LIEOWP and the Chinese *Company Law*.

To apply the trust system to the SOEs to manage the State-owned assets thoroughly and effectively, it is suggested that China should first enact a uniform “Law of State-owned Companies” so as to segregate the provisions for the SOCs from the present *Company Law*. On the one hand, it will let the present *Company Law* function optimally; on the other hand, both the incorporated SOCs and unincorporated SOEs can be governed by the same “Law of State-owned Companies” as opposed to the present Chinese *Company Law*.

In addition, from the managerial perspective, the trust system is not as efficient as the company system, so the organisational structure of the SOCs governed by the uniform “Law of State-owned Companies” can still adopt the mechanism of the modern company system. Moreover, for achieving the efficient enforcement of the duties of the directors and other managerial personnel of the SOCs, the fiduciary duties of the directors, supervisors, and managers provided for by the Chinese *Company Law* (art. 59 to art. 63) can be borrowed by the uniform “Law of State-owned Companies” or written into the trust instrument when the trust is created.

# Chapter 7

## Towards Perfecting the Chinese Law of Trusts

The enactment of the Chinese Law of Trusts is a milestone in Chinese legal history. Nevertheless, because of the deficiencies in the drafting technique and in its contents, the Chinese *Law of Trusts* is not a sophisticated, or even an adequate, instrument. That legislation needs to be improved progressively. To perfect the Chinese *Law of Trusts*, it is first necessary to understand the deficiencies in that *Law*.

### 7.1 The Deficiencies in the Chinese Law of Trusts

#### 7.1.1 Deficiencies

The comparative study of the Australian and the Chinese *Law of Trusts* in Part One of this thesis revealed the problems and deficiencies in the Chinese *Law of Trusts*. Summing up these problems and deficiencies, they collectively lie in the following aspects.

##### ***7.1.1.1 Deficiencies in the provisions regulating the methods of creating a trust***

Article 8 of the Chinese *Law of Trusts* provides:

- (1) A trust must be created in writing.

- (2) The written formalities comprise the trust contract, the will, or other written documents prescribed by laws or by administrative regulations.
- (3) Where a trust is created by a trust contract, the trust is created when the trust contract is signed by the trust parties. Where a trust is created by any other written document, the trust is created when the trustee accepts the trust.

This article prescribes the three methods of creating a trust: by contract, by will, or by other written documents prescribed by laws and administrative regulations. However, the provisions of this article disclose two deficiencies. First, the provision in article 8 (3) is inappropriate. With respect to the creation of a trust by contract, article 8 (3) inappropriately provides that the trust is created when the trust contract is signed by the parties to the trust contract. As discussed in Chapter Two of this thesis,<sup>1</sup> a trust which is created when the parties to the trust contract signs the contract can only exist in the case where the settlor creates the trust for valuable consideration. Where a settlor creates a trust voluntarily by a contract, the trust contract is a gratuitous contract. Thus, the trust must be created at the time when the property is transferred to the trustee.

With respect to the creation of a trust by other written documents, article 8 (3) of the *Law* requires that “where a trust is created by other written documents, the trust shall be created when the trustee accepts the trust”.<sup>2</sup> However, it is unclear what the phrase “accepts the trust” actually means. Does it mean that the trustee accepts the transfer of the trust property, or does it merely mean that the trustee agrees to be the trustee? Also, if the purported trustee is required to accept the trust in writing, then can a trustee accept the transfer of the trust property by conduct without giving any written form of acceptance? If the trustee accepts the trust by conduct and there is no

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<sup>1</sup> . See section 2.3.2 “Complete Constitution of Trust under the Civil Law” of this thesis.

<sup>2</sup> . “The other written documents” provided for by article 8 (3) are the same as those provided for by article 8 (2). They do not include will, because, according to article 13 (2) of the Chinese *Law of Trusts*, a trust which is created by a will will not void for want of a trustee.

writing, can the trustee retain the property as his/her own absolute property? Is the trust created if the trustee only agrees in writing to be the trustee without the transfer of the trust property? There are no answers to these questions if the phrase “accepts the trust” remains unchanged.

Thus, it is suggested that it should be better if the creation of a trust by written documents other than contracts and wills should be changed so as to read “a trust created by a written document other than a contract or a will shall be created only when the trust property is transferred to the trustee”. The acceptance of the trust property will be the proof that the purported trustee accepts the trust.

Secondly, to provide contract as the main method of creating a trust is not advantageous for the development of the Chinese trusts.<sup>3</sup> Contract is regarded as the main method of creating an express trust *inter vivos* in the Civil Law jurisdictions.<sup>4</sup> According to article 8 (2) of the Chinese *Law of Trusts*, contract is also provided as the main method of creating a trust *inter vivos*. Although a trust *inter vivos* may be created by other written documents than contract, the method of creating a trust *inter vivos* by other documents is exceptional and is a supplementary method to the methods of creating such a trust by contract, because such other written documents must be in accordance with laws or administrative regulations.

Generally, a trust which is created by a contract may produce problems both in practice and in theory. The most complicated problem is the reconciliation of the trust relationship with the contract relationship. According to the contract relationship, the parties to the trust contract are the settlor and the trustee, but the beneficiary is not a party to that contract; whereas according to the trust relationship, the beneficiary is the most important party to the trust. On the contrary, although the settlor is regarded

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<sup>3</sup> It is noteworthy that a trust is not a contract although the former is mainly created by the latter in the Civil Law jurisdictions. See section 1.3.2 “Trust and Contract” of this thesis.

<sup>4</sup> See the South Korean *Law of Trusts*, article 2; and the *Law of Trusts* of ROC, article 2.

as a party to a trust under the Civil Law, he/she is not a party to a trust under the Common Law, because the settlor has nothing to do with the trust after the creation of the trust unless he/she reserves rights of intervention in the trust instrument. However, because the settlor and the trustee are the parties to the trust contract, they can, according to the principles of contract law,<sup>5</sup> modify the contractual terms, including changing the benefits and the beneficiaries; whereas according to the trust relationship, a settlor and a trustee cannot vary the terms in the trust instrument by agreement after the trust is created except where the settlor reserves such a right. To reconcile the contradiction, article 51 (1) (c) of the Chinese *Law of Trusts* provides that the changes to beneficiaries or to the beneficial interest of any beneficiary must be made with the consent of the relevant beneficiaries or beneficiary.

Also, if the settlor is the sole beneficiary, the trust relationship and the contract relationship overlap. In this case, it seems that it is redundant to consider the contractual aspect of the trust because the settlor/beneficiary and the trustee are both the parties to the trust relationship as well as to the contract relationship. However, according to the general principles of contract, none of the parties to a contract can revoke the contract or change the contractual terms without the consent of the other party, whereas under a trust, according to article 50 of the Chinese *Law of Trusts*, a settlor who is the sole beneficiary can revoke the trust without the consent of the trustee. In this case, the settlor who is the sole beneficiary not only terminates the trust, but also terminates the trust contract creating the trust. In addition, although article 50 of the Chinese *Law of Trusts* does not indicate whether the settlor can partially terminate the trust, it is thought that the settlor who is the sole beneficiary should be able to terminate the trust partially since he/she can terminate the whole trust. If the

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<sup>5</sup> . See article 77 of the Chinese *Contract Law*, which provides “parties to a contract can vary the contract by agreement”.

settlor can partially terminate the trust, it will amount to a variation of trust. Thus, since a settlor who is the sole beneficiary can either terminate or vary the trust, the trust contract between the settlor and the trustee has no binding effect on the parties.

Again, there may be several trustees of a trust. Where the settlor enters into a trust contract with several trustees to create a trust and where a new trustee is appointed, the questions as to whether the settlor should enter into a new contract with the new trustee, whether the new trustee should join in the former single trust contract, or whether the settlor should enter into a new contract with all of the trustees may arise. If the settlor enters into a new contract with the new trustee, it seems strange that the same trust can be created by two different trust contracts entered into at different times. In addition, the new trustee may be also one of the beneficiaries of the same trust. Where the settlor enters the new trust contract with the trustee who is also one of the beneficiaries, because the trustee is the party to the trust as well as the party to the trust contract, there exists a possibility that the trustee may damage the beneficial interest of other beneficiaries in dealing with trust affairs. If the new trustee joins in the former new single trust contract, there would be the question whether he/she should be consented merely by the settlor or by both the settlor and other trustees. If the settlor enters into a new single trust contract with the new trustee and other trustees of the former trust contract, the former trust contract must be terminated. That will make the trust complicated just because of the appointment of a new trustee.

Moreover, other problems will arise in the case of the death of the trustee and in the case of the appointment of a new trustee by the court. In the case where the settlor dies and afterwards a new trustee is appointed, there will be no contract between the deceased settlor and the new trustee. In the case where the new trustee is appointed by

the court, there would be another question whether or not the new trustee should be governed by the trust contract between the settlor and other trustees.

Furthermore, if contract is regarded as the main method of creating a trust, it would limit the adoption of declarations of trust which cannot be created by contract because the settlor cannot enter into a trust contract with himself/herself.

Viewing the provisions of article 8 of the Chinese *Law of Trusts*, they seem to be influenced deeply by the theory of contract. The law makers of the Chinese *Law of Trusts* envisaged that a trust *inter vivos* should be created by a bilateral juristic act rather than a unilateral act, so contract is made the main method of creating a trust. However, they might also have considered that trusts are often created by unilateral juristic acts under the Common Law jurisdictions, namely that a trust is created by the settlor's intention, either in oral form or in written form, plus the transfer of the trust property from the settlor to the trustee except where there is a declaration of trust. Thus, article 8 of the Chinese *Law of Trusts* provides that, except for contracts or wills, other written documents prescribed by laws and administrative regulations can create a trust if the trustee agrees to accept the trust.

It is suggested that it should be more pertinent to provide that a trust can be created by either a unilateral or a bilateral juristic act, so long as the trust property is transferred from the settlor to the trustee except where it is otherwise provided by law (for example in the case of a declaration of trust, there is no scope for a transfer of the trust property) or where the trust is created for valuable consideration.

#### **7.1.1.2. Improper expansion of the rights of the settlor**

As discussed in Chapter Three (“Trust Parties”) of this thesis, under the Common Law jurisdictions, the settlor is usually not regarded as a party to a trust although he/she creates the trust, because the settlor has nothing to do with the trust property

and the beneficial interest of the beneficiary after the trust is created unless he/she reserves rights of intervention in the trust instrument.

By contrast, the Chinese *Law of Trusts* clearly provides that the settlor is one of the parties to a trust and confers many rights on him/her.<sup>6</sup> Since it is provided that a trust *inter vivos* is created by a trust contract between the settlor and the trustee, the settlor can reserve the rights he wants to exercise under the trust contract. It is not necessary to confer such detailed rights on the settlor. Giving these specific rights to the settlor is not only unnecessary, but it is also an improper expansion of the rights of the settlor.

In the light of article 49 (1) of the Chinese *Law of Trusts*, the beneficiary has the same rights of the settlor as those embodied in articles 20, 21 and 22 of the *Law*, which are mainly the following: the right to demand an explanation of the trustee as to the conduct of the trust affairs; the right to inspect the trust accounts of the trust property and other documents relative to the conduct of the trust affairs; the right to demand that the trustee change the methods of administering the trust property; the right to apply to the court to avoid the disposal of the trust property; the right to demand that the trustee restore the trust property or to compensate for the loss of the trust property; and the right to dismiss the trustee in accordance with the terms of the trust or to apply to the court to dismiss the trustee. These rights are essentially the rights of a beneficiary rather than of a settlor. If the settlor thinks any of such rights are important for him/her, he/she can reserve it in the trust contract or other trusts documents. Thus, if a settlor does not reserve such rights in the trust documents, he/she should not enjoy such rights.

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<sup>6</sup> The Chinese *Law of Trusts*, articles 20, 21, 22, 23, 31 (3), 40 (1), 50, and 52.

In respect of the right to appoint a new trustee, the Chinese *Law of Trusts* unjustifiably expands the right of the settlor. According to the definition of the trust provided for by article 2 of the *Law*, a trust includes the following three elements: a trust is created on the basis that the settlor has confidence in the trustee; the settlor mandates his/her property to the trustee; and the trustee administers the trust property for the interest of the beneficiary. Thus, a trust created by a trust contract is similar to an agency created by a mandate contract except for the distinction that the trustee is the legal owner of the trust property while the agent is not the owner. Accordingly, when a trustee is dead, incompetent or goes bankrupt, the trust contract should terminate and there is no question of the appointment of a new trustee. The appointment of a new trustee can only be obtained by the new trust contract between the settlor and the new trustee. However, considering the specialty of trust, article 52 of the Chinese *Law of Trusts* provides that a trust shall not be terminated because of the death, incompetence, bankruptcy of the settlor or the trustee. Therefore, article 40 (1) of the *Law* provides that if the trustee's office terminates by virtue of certain reasons, such as the death, bankruptcy, incompetence, or dismissal, the settlor is entitled to appoint a new trustee or new trustees; if the settlor is unable or unwilling to appoint, the beneficiary is entitled to appoint. Although a trust does not fail for want of a trustee, to let the settlor have the priority in appointing a new trustee is not reasonable because the trust is created for the beneficiary, not for the settlor. It is suggested that where the circumstances of appointing a new trustee or new trustees occur, the appointment should be conducted in accordance with the terms of the trust instrument. If there are no such terms in the trust instrument, the existing trustee or trustees, the beneficiary, or the settlor may appoint the new trustee. In addition, the court should also be empowered to appoint a new trustee or new trustees.

As far as the settlor's right to terminate a trust and to change the beneficiary or the beneficiary's beneficiary right is concerned, the Chinese *Law of Trusts* again increases the settlor's rights. Article 50 of the *Law* provides that a settlor who is the sole beneficiary can revoke the trust. It is noteworthy that to terminate a trust is the specific right of an absolutely entitled beneficiary, because he/she is the beneficial owner of a trust; whereas a settlor, no matter whether or not he/she reserves any right in the trust instrument, is not an owner of the trust property. Although it is right for article 50 of the Chinese *Law of Trusts* to provide that a settlor who is the sole beneficiary can revoke the trust, it is because the settlor is the sole beneficiary, and not because he/she is the settlor. It is suggested that it should be better to provide that a beneficiary who is of full legal capacity and absolutely entitled to the trust property can terminate a trust. This suggestion is not contradictory to article 50 of the Chinese *Law of Trusts*. If the settlor is the sole beneficiary, he/she is absolutely entitled to the trust property.

In addition, article 51 of the Chinese *Law of Trusts* provides that a settlor can change a beneficiary or dispose of the beneficial rights of the beneficiaries in the case where the beneficiary has committed a serious tort in relation to the settlor or other beneficiaries, where the settlor has obtained the consent of the beneficiary, or where it is otherwise provided for by the trust documents. As discussed in Chapter Five ("Variation and Termination of Trusts") of this thesis, this article may damage both the basic principle of contract law and the trust principle of the certainty of beneficiaries. In addition, the term "serious tort" is somewhat indefinite. Furthermore, a serious tort may be caused by either intention or negligence, so serious torts caused by different reasons should be differentiated. In fact, article 51 of the Chinese *Law of Trusts* also improperly increases the rights of a settlor.

### **7.1.1.3 Mono-type of trusts**

Under the Common Law jurisdictions, trusts are divided into express trusts, resulting trusts and constructive trusts. The three categories of trusts constitute a complete system of trusts.

In contrast, in China, there is only one type of trust, the express trust. Even the type of express trust is not complete because an owner of property cannot declare himself/herself a trustee of it. To function optimally, the trust system should be complete; otherwise, it cannot regulate some relationships. For example, if the declaration of trust is not recognized, some people who want to act as trustees by themselves cannot create a trust by declaration. Thus, the methods of creating trusts in China are severely limited.

Also, under the Common Law, resulting trusts are important in dealing with the surplus of trust property or the undisposed property transferred to a trustee and in preventing a person from being unjustly enriched. In the former case, for example, where a person created a trust to sponsor one of his relatives to go to university by transferring a sum of money to a trustee and there is surplus of the sum of money after the relative of the settlor graduated, the trustee holds the surplus on resulting trust for the settlor. In the latter case, for example, where a person transfers the title of his/her house to another person voluntarily, and there is no presumption of advancement, there is a presumption that the other person holds the title of the house on a resulting trust for the transferor. If the presumption of resulting trust is un rebutted, the resulting trust is called a presumed resulting trust.

Because all the trusts must be express trusts and be created in writing, the Chinese *Law of Trusts* does not provide any solution to deal with the circumstances where a presumed resulting trust under the Common Law is created. Such circumstances are

beyond the range of the Chinese *Law of Trusts*. They will be regulated by other Chinese civil law institutions, such as the gift or unjust enrichment.

With respect to a surplus of the trust property of an express trust, article 54 of the Chinese *Law of Trusts* provides:

Where a trust is terminated, the trust property shall belong to the person specified in the trust instrument to take the property upon termination. Where the trust instrument does not specify any such person, the trust property shall belong to the persons in the following order:

- (1) the beneficiary or the heirs of the beneficiary;
- (2) the settlor or the heirs of the settlor.

Since a trust is terminated for various reasons, the surplus of the trust property should be returned to the settlor if the trust instrument does not specify any person who is entitled to the surplus. It is unreasonable for article 54 of the *Law* to provide for an order to distribute the surplus of the trust property where the trust instrument does not specify any person in whom the trust property can be vested. In fact, the order excludes the settlor from enjoying the surplus, because both the beneficiary and his/her heirs can enjoy the surplus of the trust property. Also, according to article 51 of the *Law*, a settlor may revoke a trust if the beneficiary commits serious tort in relation to him/her. Where the trust is terminated because of the serious tort committed by the beneficiary in relation to the settlor, how can the trust property still belong to the beneficiary or his/her heirs according to article 54 of the *Law*? The two articles are mutually contradictory at this point.

Again, as discussed above,<sup>7</sup> where a trust is rescinded by reason of being prejudicial to the interests of the creditor of the settlor according to article 12 (1) of the Chinese *Law of Trusts*, it is deemed not to have been created from the very beginning, and the trustee must return the property to the creator of the rescinded trust

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<sup>7</sup>. See section 4.2.2.2.2 “Several problems relating to the termination of the trust in China” of this thesis.

or to his/her heirs. Thus, article 54 of the Chinese *Law of Trusts* does not apply to a rescinded trust.

In addition, a trust may be terminated if the beneficiary disclaims his/her beneficial rights. Article 46 of the *Law* provides:

- (1) The beneficiary may disclaim his/her beneficial rights.
- (2) Where all the beneficiaries disclaim their beneficial rights, the trust is terminated.
- (3) Where one or more than one of the beneficiaries disclaim their beneficial rights, the disclaimed beneficial rights shall belong to the persons in the following order:
  - (a) prescribed by the terms of the trust instrument;
  - (b) other beneficiaries;
  - (c) the settlor or the heirs of the settlor.

In the case provided by article 46 (3), the beneficial interest disclaimed by one or some of beneficiaries should be held on resulting trust for the settlor, but article 46 (3) (b) and (c) provide for an unreasonable order. It is suggested that the disclaimed beneficial rights should be enjoyed by other beneficiaries only in the case where there is no other persons prescribed by the terms of the trust instrument [art. 46 (3) (a)] and the settlor has decided to give away his entire interest in the relevant property. It is therefore suggested that the order prescribed by (b) and (c) be reversed.

Moreover, if the trust is terminated by reason of all the beneficiaries' disclaiming the beneficial interests according to article 46 (2) of the Chinese *Law of Trusts*, why should the heirs of the beneficiary can still obtain the trust property according to article 54 of the *Law*? The result is illogical.

Thus, the exclusion of resulting trusts will produce major legal problems of the Chinese *Law of Trusts* and will result in, undoubtedly, some practicable problems in the course of applying the *Law* in the future.

Like resulting trusts, constructive trusts are also an important component of a complete trust system, but, unlike the express trusts and presumed resulting trusts which are created by the express intention or the implied intention of the creators, constructive trusts are created by operation of law. Under the Common Law, a constructive trust is imposed whenever equity considers it unconscionable for the legal owner of property to deny another person's partial or entire beneficial interest therein. For example, if a person knowingly assisted a trustee to breach his duties, and in giving that assistance he acquired property or made a profit, he would hold the property or the profit on constructive trust for the person to whom the duty was owed.

Under the Civil Law, except that the *Civil Code of Quebec* provides a trust can be created by operation of law in certain cases,<sup>8</sup> constructive trusts are not recognized by the *Law of Trusts* of Japan, South Korea, Taiwan and China. It might be thought that constructive trusts are the result of the operation of equity, so it is not necessary to provide for constructive trusts in China. However, although there is no division of common law and equity in China, the basic principles of fairness, honesty and good faith of the Chinese *Law of Trusts* also require that a person cannot obtain property or make a profit unconscionably.<sup>9</sup> For example, article 22 (1) of the Chinese *Law of Trusts* requires that if a trustee disposes of the trust property in violation of the purpose of the trust and a third party knows that he/she accepts the trust property in violation of the purpose of the trust, the third party should return the trust property or compensate the losses. However, to demand that the third party return the trust property or compensate for the losses of the trust property are civil law remedies and the remedies cannot solve the problem of whether the third party should return any increase in the value of the trust property.

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<sup>8</sup> . The *Civil Code* of Quebec, article 1262.

<sup>9</sup> . The Chinese *Law of Trusts*, article 5 and article 25.

If a constructive trust was recognized in China, this problem would have been solved. A constructive trust would be imposed on the third party to hold the property on trust for the beneficiary, so any increase in the value of the property or any alternation form of the property would still be the trust property.

In addition, some problems which the resulting trusts cannot solve can be solved by constructive trusts. For example, A gives \$ 1 million to B in trust for C, and B accepts the trust orally, but later B refuses to carry out the trust. Clearly, a resulting trust cannot be imposed on B. However, because all the trusts must be created in writing in China, the trust is not created, given that it was not created in writing. In this case, although A can demand the return of the money according to article 58 and article 61 of the Chinese GPCL,<sup>10</sup> the purpose of creating the trust cannot be achieved. Thus, if a constructive could be imposed on B to hold the money on trust for C, the problem could be easily solved.

A constructive trust can not only apply to a circumstance in relation to a trust, but also apply to other circumstances in which a person unconsciously receives property.

Therefore, the mono-type of trusts cannot make the Chinese *Law of Trusts* operate optimally.

## **7.1.2 The Reasons for the Deficiencies in the Chinese Law of Trusts**

The legislative deficiencies in the Chinese *Law of Trusts* emanate from several sources. The most important source is the differences between the Chinese legal system and the Common Law system.

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<sup>10</sup> . According to article 58 (1) (e) of the Chinese GPCL, a trust which is not created in writing is void. According to article 61 of the GPCL, after a juristic act has been determined void, the party who acquired property as a result of the act must return the property to the other party.

The Common Law system embodies two legal systems, the common law and equity. Equity seeks fairness and justice. It is a legal system that supplements the common law, which is both deficient and harsh in some respects, by recognising some rights and remedies which the common law does not recognize; and it corrects the common law where it is regarded as harsh. Trust is the most important and peculiar institution of equity which the common law (as opposed to equity) does not recognize because the common law does not recognize the beneficial ownership of the beneficiary. Equity recognizes the beneficial ownership, but it does not deny the legal ownership of the trustee. Thus, there exists the phenomenon of duality of ownership in the Common Law system.

Because there is no division of equity and the common law under the Chinese legal system, which stems from the Civil Law, the double ownership system is not recognized in China. The traditional Chinese system of ownership is posited on the concept of single ownership, which means there cannot be two ownerships of the same thing simultaneously. The acceptance of trust into the Chinese legal system unavoidably results in conflicts between the two different legal systems and it is impossible to reconcile the inconsistencies. Thus, in the course of drafting the Chinese *Law of Trusts*, it was inevitable for the *Law* to contain such inconsistencies and deficiencies.

Secondly, the Chinese *Law of Trusts* is deeply influenced by its counterparts in Japan, South Korea and Taiwan. The influence of the Law of Trusts of Japan, South Korea and Taiwan lies not only in the fact that the Chinese legal tradition is the same as these Civil Law jurisdictions, but lies also in the legislative purposes.

Because of the same legal tradition, the basic principles, concepts and the layout of the civil codes in Japan, South Korea and Taiwan are almost the same. Although

there has not been a complete civil code in China so far, the theoretical structure of the Chinese civil law is the same as the civil codes of the above three Civil Law jurisdictions. It is believed that the future Chinese Civil Code would adopt the same structure as that of Japan, South Korea and Taiwan.

It is noteworthy that the enactment of the law of trusts in the above Civil Law jurisdictions was designed to promote the development of business trusts rather than the development of the whole trust system. The law of business trusts is given more attention than the entire law of trust in these jurisdictions. For example, in Japan, the *Law of Business Trusts* and the *Law of Trusts* were enacted on the same day, namely on April 21, 1922. On June 4, 1951, the Japanese *Securities Investment Trust Law* was enacted. One year later, the Japanese *Loan Trusts Law* was enacted, on June 14, 1952. In Taiwan, the *Banking Law*, which was enacted in 1931 and amended on November 1, 2000, provides for Trust and Investment Companies with the whole Sixth Chapter. On November 28, 1984, the *Regulations on the Administration of the Trust and Investment Companies* were promulgated in Taiwan. On June 30, 2000, the *Law of Business Trusts* of Taiwan was promulgated and took effect. It seems that the laws of trusts in Japan and Taiwan only provide basic trust concepts and principles for the special laws or regulations in relation to trusts.

Similarly, under the influence of Japan and Taiwan, the Chinese *Law of Trusts* was promulgated in April 2001 only three months after the enactment of the Chinese *Regulations on the Management of the Trust and Investment Companies*. Undoubtedly, paying more attention to the business trusts than the basic trust system in legislation is one of the reasons for the legislative deficiencies in the Chinese *Law of Trusts*.

Thirdly, the limitation of both legal and economic environments is also a source of the deficiencies in the Chinese *Law of Trusts*. During the Cultural Revolution, China plunged into lawlessness because the laws and regulations were replaced by the policies of the State and of the CPC. The Chinese people as a whole suffered from a lack of awareness of the rule of law because of the more than ten years' impact of the Cultural Revolution. By the end of the 1970s, China began to emerge as a society governed by the rule of law. However, the legal awareness of the Chinese People is still at a low level. The propaganda, the research and the enactment of laws and regulations continue to be backward and remain to be improved. The legal environment in China is not sufficiently sophisticated to accommodate a comprehensive law of trusts. In addition, China lacks the advanced economic environment to support a comprehensive law of trusts. Although the Chinese economy has expanded rapidly since the economic reform of the late 1970s, China is still a developing country rather than a developed country. Most of the Chinese people are still desperately struggling to make a living. They have no surplus money to be used in ways other than that of paying for their food and shelter. There is no scope for most of the Chinese people to use a trust to dispose of their assets. Thus, lacking both the legal and economic environment for a comprehensive law of trusts, the Chinese *Law of Trusts* is understandably underdeveloped.

Fourthly, the lack of academic research on the law of trusts is another source of deficiency in the Chinese *Law of Trusts*. Because of the Civil Law tradition in China, the trust, which is an institution of central importance in the Common Law, was not noticed in China until the beginning of the 1990s.

Before the enactment of the Chinese *Law of Trusts* in 2001, there were only three books on trusts written by scholars from the Mainland China: namely, the *Principles*

*of Trusts Law* by Zhang Chun, which was published in 1994; the *Comparative Study on Trusts Law* by Zhou Xiaoming, which was published in 1996; and the *Law of Trusts* by Shi Tiantao and Yu Wenran, which was published in 1999. The first of the three books was based mainly on the translation of the English books on trusts and adopted the traditional structure of Chinese law textbooks. The second book, the *Comparative Study on Trusts Law* was based mainly on the trusts books written by scholars of Taiwan, and half of the contents of the book were in relation to the Chinese business trusts. The third book, the *Law of Trusts*, was mainly based on the above second book and added nothing new. In regard to articles on trusts, there were only less than 20 and most of them discussed the business trusts rather than the basic trust concept and principles. The dearth of academic research on trusts in China meant that there was inadequate preparation for the enactment of the Chinese *Law of Trusts*. The deficiencies embodied in the Chinese *Law of Trusts* can be found to have been derived from the lack of relevant academic research.

Lastly, one of the legislative purposes of the Chinese *Law of Trusts* is another source which results in the deficiencies. As discussed above, like the *Law of Trusts* in Japan, South Korea and Taiwan, an important purpose of the enactment of the Chinese *Law of Trusts* is to serve the Chinese *Regulations on the Management of the Trust and Investment Companies*. If there was no basic law of trusts, the *Regulations* would not function optimally and the business trusts of China could not be developed efficiently. However, it seems that the legislative purpose put the incidental element above the fundamental one. A law of business trusts must be based on a basic law of trust. There cannot be an efficient law of business trusts if there is not a sound law of trusts. Paying too much attention to the business trust or even enacting a law of trusts

merely to facilitate a law of business trusts will necessarily prejudice the formulation of a basic law of trusts.

## 7.2 Perfecting the Chinese Law of Trusts

The deficiencies existing in the Chinese *Law of Trusts* are causing, and will continue to cause, many problems in practice. Generally, one or two years after a law is enacted, the Supreme People's Court of China will have to issue interpretations on the application of the law. Unusually, so far the Chinese People's Supreme Court has not issued any interpretations on the application of the Chinese *Law of Trusts* although the *Law* was enacted three years ago. This may be due to a number of reasons. The first is that the trusts law is really a new and complicated legal concept, and it is difficult to promulgate interpretations in relation to the application of the Chinese *Law of Trusts* within two years. The second is that the role of the *Law* has not achieved what was expected of it, so it is not opportune for the Supreme People's Court of China to issue such interpretations. Thirdly, the Chinese *Law of Trusts* has not been valued much since it was enacted. Rather, the business trusts are always given importance. For example, On October 28, 2003, the Chinese *Securities Investment Fund Law* was enacted in the Fifth Session of the Standing Committee of the Tenth National People's Congress of China.<sup>11</sup> Article 2 of the *Law* provides that the Chinese *Law of Trusts* shall be applied to the cases where there are no provisions stipulated by the *Securities Investment Fund Law*. Unfortunately, paying more attention to the business trust than to the basic trust system has impeded the process of improving the Chinese *Law of Trusts*. Similarly, there are also deficiencies in the laws or regulations concerning the business trusts without the improvement of the basic

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<sup>11</sup>. In Japan, the *Securities Investment Trust Law* was enacted in 1951; In Taiwan, the *Regulations on the Management of the Securities Investment Trust Fund* was enacted in 1972.

Chinese *Law of Trusts*, because the basic trusts law offers its deficient general principles and concepts to other special laws and regulations in relation to the business trusts.

Therefore, improving and perfecting the Chinese *Law of Trusts* is of the first importance in developing the Chinese business trusts soundly and to let the laws and regulations in relation to trust function optimally so as to promote the development of the Chinese economy.

In the light of the discussion and analysis of the deficiencies adverted to in the previous chapters and this chapter of this thesis, it is suggested that the improvement of the Chinese *Law of Trusts* should be undertaken mainly in the following two aspects: to remedy the existing deficient provisions of the Chinese *Law of Trusts* and to accept selectively the advanced principles of the law of trusts of Australia and of other Common Law Jurisdictions.

## **7.2.1 Remediating the Existing Deficient Provisions of the Chinese Law of Trusts**

The deficiencies in the existing provisions of the Chinese *Law of Trusts* have been discussed in this Chapter. Accordingly, the remedy of the existing deficient provisions should concentrate on the following goals: to supplement the methods of creating a trust; to recast the rights of the settlor and confer more rights on the beneficiary; and to systematize the duties of the trustee and confer more specific powers on the trustee.

### ***7.2.1.1 Supplementing the methods of the creating a trust***

Article 8 of the Chinese *Law of Trusts* provides three methods of the creation of express trusts, namely, by contracts, wills, or by other written documents. However,

according to the legislative purpose and the legislative experiences of trusts law in Japan, South Korea and Taiwan, the third method of creating a trust is a supplementary method, while the contract method is the main one. Because both contracts and other written instruments can create a trust, in order to distinguish between the time of the constitution of a trust created by a contract and that of a trust created by other written documents, article 8 (3) of the Chinese *Law of Trusts* has to provide that a trust is created when the contracting parties sign the contract if the trust created by a contract and a trust is created when the trustee accepts the trust if the trust is created by other written documents.<sup>12</sup>

With respect to a trust created by contract, it is not reasonable to provide that the trust is created when the contracting parties sign the contract. There are three reasons for this. One is that a “trust” is not a “trust contract”,<sup>13</sup> and the formation and effectiveness of a contract differ according to the type of contract.<sup>14</sup> The second reason is that article 8 (3) is inconsistent with article 2 of the Chinese *Law of Trusts*, because the latter requires, in giving the definition of the trust, the settlor/testator to mandate (transfer in common law sense) his/her property to the trustee. Thirdly, as discussed above, to provide a trust *inter vivos* is mainly created by contract will result in some deficiencies both in practice and in theory.

In respect of a trust created by the written documents other than contract and wills, it is only an unusual and supplementary type to those trusts created by contracts and wills on the one hand; on the other hand, it does not, according to the definition of trust given by article 2 of the Chinese *Law of Trusts*, include a declaration of trust.

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<sup>12</sup>. “The other written documents” provided for by article 8 (3) are the same as those provided for by article 8 (2). They do not include will, because, according to article 13 (2) of the Chinese *Law of Trusts*, a trust which is created by a will will not void for want of a trustee.

<sup>13</sup>. See also section 2.3.2 “Trust and Contract” of Chapter of this thesis.

<sup>14</sup>. See section 2.3.2 “The Complete Constitution of Trust under the Civil Law” of this thesis.

Therefore, it is suggested that article 2 and article 8 of the Chinese *Law of Trusts* should be modified so as to amend and supplement the methods of creating a trust. Specifically, it is suggested that article 8 should provide that a trust shall be created in writing together with the transfer of the trust property to the trustee. Articles 2 and 8 of the *Law of Trusts* should comprise trusts created by any written instrument, no matter whether it is a contract, a will or any other written document. In addition, a declaration of trust should be also recognized in China by an amendment to the *Law*.

### **7.2.1.2 Recasting the rights of the settlor and conferring more rights on the beneficiary**

As discussed above, because the settlor is regarded as an important party to the trust in China, the Chinese *Law of Trusts* confers an excessive number of rights on the settlor.<sup>15</sup> It is thought that the conferment is unnecessary because the settlor can reserve the rights in the trust contract or other trust instruments if he/she wishes to reserve such rights. If the settlor is one of the beneficiaries or the sole beneficiary, he/she can exercise many or all of the rights in the position of a beneficiary. In this case it is meaningless to confer on the settlor so many rights. In addition, the trust relationship is a relationship between the trustee and the beneficiary. If the settlor is given too many rights, it raises the fundamental question whether the title to the trust property has been fully transferred to the trustee and whether the trustee can manage and dispose of trust property in an efficient way. For example, according to article 51 of the Chinese *Law of Trusts*, the settlor has the right to change the beneficiary and alter the beneficiary interest of the beneficiary or beneficiaries. In this case, since the settlor still has the right to interfere with the trust property, there would be a question

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<sup>15</sup>. The Chinese *Law of Trusts*, article 20 – 23; article 40, 50 and 51.

that who, the settlor or the trustee, should pay a tax imposed on the trust property and a question whether the trustee can administer the trust property efficiently.

It is suggested that the settlor's rights should be reformed by the Chinese *Law of Trusts*. The rights and duties of a trust can be reduced to the rights and duties of the beneficiary and the trustee. For example, the right to access the trust accounts by the settlor can be provided as the beneficiary's right and the trustee's duty. Namely, the settlor has the beneficiary's right to access the trust accounts and the trustee has the duty to inform the beneficiary and the settlor of the administration affairs of the trust property. In addition, it is suggested that the Chinese *Law of Trusts* might provide that the settlor can reserve some rights in the trust contract or the trust instrument.

Although the Chinese *Law of Trusts* confers on the beneficiary many rights, the *Law* does not confer him sufficient rights, especially the right to terminate the trust. The aim of creating a trust is to benefit the beneficiary, so the right to terminate a trust is a very important right of the beneficiary. Article 50 of the Chinese *Law of Trusts* confers the right to terminate a trust on the settlor who is also the sole beneficiary, but it does not provide for termination by a sole beneficiary who is not the settlor, or by beneficiaries who are together absolutely entitled to the trust property. In addition, in certain circumstances, the beneficiary's right is provided only as a right which is supplementary to the settlor's right. For example, in respect of the appointment of a new trustee or new trustees, article 40 of the *Law of Trusts* provides that the appointment of a new trustee shall be in accordance with the trust instrument. Where the trust instrument does not provide for the appointment of a new trustee, the beneficiary does not have right to appoint a new trustee unless the settlor does not or is unable to exercise such rights. Furthermore, the Chinese *Law of Trusts* does not confer on the beneficiary further rights. For example, article 31 (2) of the *Law*

provides that co-trustees must deal with trust affairs jointly. If they disagree with each other, they must deal with trust affairs in accordance with the trust instruments or deal with trust affairs according to the joint decision of the settlor, the beneficiary and other interested persons. But this article does not provide what the co-trustees should do if the settlor, the beneficiary and other interested persons could not reach agreement on how to instruct the trustee how to deal with trust affairs when the co-trustees have disagreement on their administration of trust affairs.

It is suggested that the Chinese *Law of Trusts* should confer more rights on the beneficiary. In respect of the right to terminate the trust, the *Law*, like the trusts law under the Common Law, should provide that the beneficiaries can terminate the trust so long as the beneficiaries are of full legal capacity and are together absolutely entitled to the beneficial rights to the trust property since they are beneficial owner of the trust property.

In addition, since the beneficial interest of the beneficiary is the aim of creating a trust, the beneficiary's right rather than that of the settlor should be given more attention. Thus, in some circumstances, such as where the co-trustees disagree with one another in dealing with the trust property, or where the new trustee shall be appointed to replace the resigned or dismissed trustee, the beneficiary has the right to direct the trustee or to appoint the new trustee. Where the beneficiary is unwilling or unable to direct the trustee or to appoint a new trustee, the beneficiary, the settlor, the trustee or other interested person can apply to the court to decide what the trustees should do if they disagree on what should be done with the trust property, and apply to the court to appoint the new trustee or new trustees where appropriate.

### **7.2.1.3 Conferring more specific powers on the trustee**

For administering and disposing of the trust property for the benefit of the beneficiary, a trustee must be given powers. Although Section Two of Chapter Four of the Chinese *Law of Trusts*, which deals with the duties and rights of the trustee provides for detailed duties of the trustee, which can be divided into three levels from the point of view of structure,<sup>16</sup> it does not directly confer powers on a trustee. Rather, the Chinese *Law of Trusts*, like other trusts law in Japan, South Korea and Taiwan, imposes an overarching duty on the trustee to administer the trust affairs for the best benefit of the beneficiary. However, the overarching duty can be also regarded as a general power conferred on the trustee. Article 25 of the *Law* provides that “a trustee shall administer trust affairs for the optimal interests of the beneficiary in accordance with the trust instruments”. It is an article providing for the duty of the trustee which requires the trustee to conduct trust affairs in accordance with the trust instruments, as well as an article providing that the trustee has the right and power to administer the trust affairs.

Obviously, merely conferring such a general power of administering trust affairs is insufficient for a trustee to administer and dispose of the trust property efficiently. It explains that the Chinese *Law of Trusts* has not realized the importance of the powers of a trustee. Thus, it is suggested that the Chinese *Law of Trusts* should confer specific powers on a trustee, such as the power to sell, lease, exchange and partition trust property; the power to invest; the power to sell by auction; the power renew leases; the power to raise money by sale or mortgage; the power to employ agents; the power to delegate trust; the power to carry on business; the power to audit accounts, and so forth. To confer on a trustee more specific powers, the trustee can administer

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<sup>16</sup>. See section 3.1.1.2 “duties of a trustee under the Civil Law” of this thesis.

the trust property more efficiently. With the statutory powers, a trustee can efficiently administer the trust affairs and avoid the deficiencies in the trust instrument in conferring powers on the trustee.

## **7.2.2 Accepting Selectively the Advanced Legal**

### **Principles of the Trusts Law in Australia and other Common Law Countries**

The law of trusts has a history of more than 700 hundreds of years in the Common Law jurisdictions. The advanced and developed legal systems of trusts have been refined and will be improved continuously. Different types of trusts and relative systems of trusts co-exist closely and efficiently. The advanced legal systems and the principles of the law of trusts developed under the Common Law cannot be ignored while accepting trusts law into China. Although the Chinese *Law of Trusts* has accepted the most important type of trust, namely the express trust, the function and effect of trusts in China is doubted because it is lacking in other important institutions, such as the resulting trust and the constructive trust, or principles which underpin the trust, such as the fiduciary relationship. All kinds of types of trusts and its relevant principles form a whole complete legal system of trust. Lacking for any of them, the whole complete system will be affected and cannot perform in a perfect way.

At present, the Chinese *Law of Trusts* is such that it cannot play a role that had been expected of it because only a basic part of the trust system under the Common Law has been accepted in China. If it is correct to say that the acceptance of the trust system should accommodate the conditions indigenous to China and should not therefore accept all the trust principles under the Common Law into China, it is also correct to say that the acceptance of the Common Law trust should not be truncated to

acceptance only of the express trust. Without the introduction of other types of trusts and other relevant trust principles, the express trust cannot function efficiently on its own. It is clear that to accept selectively the advanced trust systems and principles in addition to express trusts is important for China. First, it is necessary to change the status of a single type of trusts (i.e. express trusts) by recognizing resulting trusts, constructive trusts, and declarations of trusts. Secondly, developing the concept of fiduciary relationship can improve the performance of the Chinese *Law of Trusts*.

### **7.2.2.1 Accepting declaration trusts, resulting trusts and constructive trusts**

#### **7.2.2.1.1 Accepting declarations of trust**

A declaration of trust is an express trust, because the trust is created by the express intention of the creator. It arises where a person creates a trust by declaration rather than by transferring the title to the trust property. In a declaration of trust, the settlor acts the trustee by himself/herself. Because a trust *inter vivos* is regarded as created by a contract under the Civil Law jurisdictions, a declaration of trust, generally, is not recognized by the trusts law in the Civil Law jurisdiction in that the settlor and the trustee are the same person and he/she cannot enter into a trust contract with himself/herself. However, in Taiwan, there is an exception to the general position. Article 71 (1) of the *Law of Trusts* of ROC provides that a legal person can declare to the public that he/she is the trustee of a charitable trust and may invite the public to join as the settlors.

In China, it is necessary to make provision for the creation of a trust by declaration, because declarations of trust offer people a convenient way to create a trust. Some people may trust themselves rather than a different trustee in

administering and disposing of the trust property, so they can declare themselves as trustees and hold the trust property for the beneficial interest of the beneficiaries without entering into a trust contract with a trustee and without transferring assets to the trustee.

In addition, in the realm of charitable trusts, to recognize declarations of trust in China will be of great social and business significance and the business of charitable trusts will be greatly developed, because more individuals and legal persons will be encouraged to create charitable trusts directly by way of declaration. For example, in regard to the “project of hope” which has been proposed by the Chinese Central Committee of Youth League aiming at helping children from poor families to go to school, people can help the poor children by declaring themselves as trustees. On the one hand, they can have a happy feeling of helping the poor children; on the other hand, their properties can be completely used for the benefit of the beneficiaries.

However, it is suggested that when a trust is created by a declaration, the declaration should be in accordance with the writing requirement provided for by article 8 (1) of the Chinese *Law of Trusts*.

#### **7.2.2.1.2 Accepting resulting trusts**<sup>17</sup>

Resulting trusts are important trusts in the Common Law jurisdictions. Although Megarry J in *In re Vandervell's Trusts (No 2)*<sup>18</sup> expounded the concept of “automatic” resulting trust, Lord Browne-Wilkinson in *Westdeutsche Landesbank Girozentrale v Islington London Borough Council*<sup>19</sup> rejected his view and said that even the “automatic” resulting trusts give effect to intention.<sup>20</sup> Thus, all the resulting

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<sup>17</sup>. See also section 1.4.1.2 “resulting trusts” of this thesis.

<sup>18</sup>. [1974] 1 Ch 269 at 289.

<sup>19</sup>. [1996] AC 669.

<sup>20</sup>. *Ibid* at 708.

trusts are created by the implied intention of the creator. According to Lord Browne-Wilkinson,<sup>21</sup> a resulting trust arises in the following two sets of circumstances: (a) where A makes a voluntary payment to B or pays (wholly or in part) for the purchase of property which is vested either in B alone or in the joint names of A and B, there is a presumption that A did not intend to make a gift to B: the money or property is held on trust for A (if he is the sole provider of the money) or in the case of a joint purchase by A and B in shares proportionate to their contributions; (b) where A transfer property to B on express trust, but the trusts declared do not exhaust the whole beneficial interest: B will hold the remaining interest on resulting trust for A. A resulting trust arises in the above circumstance (a) is to prevent B from obtaining unjust enrichment, while a resulting trust arises in the above circumstance (b), which was called “automatic resulting trust” by Megarry J, is to return A the surplus of the trust property according to his/her implied intention.

In China, with the development of the trust system, there will arise many cases to which the “automatic resulting trusts” will be applied, because, for example, a settlor cannot accurately transfer the exact amount of assets to the trustee when he/she creates an express trust. In addition, one of the beneficiaries may disclaim his/her beneficial interest. In these cases, the “automatic resulting trusts” will be applied.

In addition, the above first cases under which resulting trusts are applied to also exist in China. For example, where two partners pool their money to buy a house which is registered in the name of one the partners, if the partner in whose name the house is registered wants to deny the other partner’s interest in the house, the partner will be made to hold the house on a resulting trust for the beneficial interest for both of them if there is no presumption of advancement.

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<sup>21</sup> . Ibid.

However, it is suggested that, like the law of trusts in Australia, there is a rebuttable presumption of advancement in favour of a voluntary transferee of property in the following situations: the transferor or the purchaser is the father or mother of the voluntary transferee; the transferor or the purchaser is the husband or wife of the transferee; the transferor or purchaser is *in loco parentis*, such as a step father or mother, to the transferee.

### **7.2.2.1.3 Accepting constructive trusts** <sup>22</sup>

As mentioned above, under the Common Law, unlike express trusts and resulting trusts which are respectively created on the basis of the express intention and the implied intention of the creator of the trust, constructive trusts are created by operation of law. It is imposed whenever equity considers it unconscionable for the legal owner of property to deny another person's partial or entire beneficial interest therein. In *Muschinski v Dodds*,<sup>23</sup> Deane J said: "In a broad sense, the constructive trust is both an institutional and a remedy of the law of equity".<sup>24</sup> Thus, constructive trusts can be divided into two categories: the institutional constructive trust and the remedial constructive trust. According to Lord Browne-Wilkinson,<sup>25</sup> an institutional constructive trust arises by operation of law as from the date of the circumstance which give rise to it; while a remedial constructive trust is a judicial remedy giving rise to an enforceable equitable obligation.

Since a constructive trust is imposed whenever equity considers it unconscionable for a person holding the title to the property to deny another person's partial or entire beneficial interest therein, it can be applied in the following cases: imposed to prevent

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<sup>22</sup> . See also section 1.4.1.3 "constructive trusts" of this thesis.

<sup>23</sup> . (1985) 160 CLR 583.

<sup>24</sup> . Ibid at 613.

<sup>25</sup> . *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669 at 714.

the statutory writing requirements from being used as an instrument of fraud; imposed on secret trusts and half-secret trusts; imposed on strangers who receive trust property either with notice of a breach of trust or pursuant to assisting in another person's breach of fiduciary duty; imposed to effectuate a disposition, transaction or relationship; imposed to prevent unconscionable acquisition of property. And the list goes on.

In China, there are no secret or half-secret trusts because all the trusts must be created expressly in writing. However, other circumstances in which a constructive trust may be imposed under the Common Law jurisdictions may also occur in China. Although there is no division of common law and equity in China, the basic principles of the Chinese *Law of Trusts* and other civil laws require no person may obtain profits unconscionably. For example, a person cannot use the statutory writing or registration requirements as an instrument of fraud; a seller cannot resell an item of property which he/she has sold to the buyer, to a third person; a person cannot be unjustly enriched. Therefore it is necessary to provide for constructive trusts in China to prevent a person from unconscionably obtaining property or profits. Most importantly, the acceptance of constructive trusts in China will be of great significance especially in preventing unjust enrichment in preventing a fiduciary using his/her position to make profits.

In China, unjust enrichment arises when a person has acquired profits unjustly without legal justification at the expense of another. Article 92 of the Chinese GPCL provides: "Where a person acquires profits unjustly without a lawful basis and results in another person's loss, he/she shall return the unjust profits to the person who suffered the loss". For example, where a person withdraws \$ 500 from a bank, but the teller negligently gives him/her \$ 600. The difference of \$ 100 is enrichment. Usually,

unjust enrichment comprises five elements: a person has been enriched; another person has suffered loss; there is causality between the act of enrichment of a person and the loss of the other; the enrichment is not justified on legal grounds; the enrichment is deemed to be unjust.

However, the Chinese GPCL does not provide for a solution to deal with the following two questions: what happens if the enrichment represented by the unjustly obtained profit is greater than the loss, and what happens if that profit is less than the loss? Some scholars from Taiwan have suggested that no matter whether the profit was greater or less than the loss, the unjustly enriched person should return the profit only to the extent of the loss. If the profit was greater than the loss, he/she should only return the part of profit equal to the loss; if the profit was less than the loss, he/she should return the profit and compensate the loss exceeding the profit.<sup>26</sup> Some scholars from Mainland China have suggested that the answer to these two questions would depend on the subjective conditions of the unjustly enriched person.<sup>27</sup> Where the person obtained the profit in bad faith, he/she should return the profit and the income thereof if the profit is greater than the loss, or he/she should return the profit and compensate the loss exceeding the profit if the profit is less than the loss. Where the person obtained the profit in good faith, he/she should only return the profit no matter the profit is greater or less than the loss.

It is suggested that both of the above two views proposed by the scholars from Taiwan and from the Mainland of China should not be followed. In regard to the first view, it will encourage unjust enrichment because the profit maker can only return the profit equal to the loss where the profit is greater than the loss. In regard to the second

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<sup>26</sup> . Dong Shifang: *The Outline of Civil Law* (1988), p 106.

<sup>27</sup> . Zhang Junhao: *The Principles of Civil Law* (1997), p 854.

view, since it is an unjust enrichment, it is doubtful whether a person can make a profit unjustly in good faith.

Thus, if the problems of unjust enrichment in China can be solved through the constructive trust, the acceptance of the constructive trust will be apposite in that the unjustly enriched person will become the trustee for the victim and hold the profit on trust for the benefit of the victim.

In addition, although there is no concept of fiduciary relationship in China, the legal relationships which bear the characteristics of a fiduciary relationship still exist, such as the relationship between agent and principal, trustee and beneficiary, lawyer and client, and director and company. Under the Common Law, a fiduciary's main duty is that he/she must not place himself/her in a position where his/her duty and interest may conflict. Likewise, in China, the above said persons, the trustee, the lawyer, the agent and the director, bear the same duty of a fiduciary under the Common Law. Where such a "fiduciary" in China breaches his/her duty and makes a profit, or a third person knowingly assists such "fiduciary" to breach his/her duties, and where in giving that assistance the third person acquired property or made a profit, a constructive trust can be imposed on the default "fiduciary" or the third person to hold the property or the profit on trust for the person to whom the duty was owed.

However, the significance of a constructive trust imposed on a fiduciary will not be appreciated until the concept of fiduciary relationship is established law in China. Thus, developing a concept of fiduciary relationship in China is necessary.

### ***7.2.2.2 Developing a concept of fiduciary relationships***

As with the definition of a trust, there is no universally accepted definition of a fiduciary relationship. The fiduciary relationship is a concept in equity. Generally, a fiduciary relationship is a relationship of trust and confidence, under which a person

(fiduciary) undertakes to act in the interest of another. In *United States Surgical Corporation v Hospital Products International Pty Ltd*,<sup>28</sup> the NSW Court of Appeal declared that a fiduciary relationship exists where in a particular matter a person had undertaken to act in the interest of another person and not to act in his own and that this “representative” element was essential and it is from the fiduciary’s undertaking to subordinate his interest that the beneficiary’s expectation, or his trust and confidence, that the fiduciary would act accordingly arose.<sup>29</sup>

Since a fiduciary acts in the interest of another person rather than himself/herself, he/she is placed under some duties. In *Bristol and West Building Society v Mothew*,<sup>30</sup> Millett LJ depicted the duties of a fiduciary by saying:<sup>31</sup>

[S]omeone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary. This core liability has several faces. A fiduciary must act in good faith; he must make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he must not act for his own benefit or for the benefit of a third person without the informed consent of his principle. This is not intended to be an exhaustive list, but it is sufficient to indicate the nature of fiduciary obligation.

It is clear that the overarching duty of a fiduciary is the duty of loyalty. The most important aspect of the duty of loyalty is that a fiduciary must not place himself/herself in a position where his/her duty and his/her interest may conflict. In Australia, a fiduciary should avoid not only a real conflict, but also a real possibility of conflict between his/her duty and his/her interest.<sup>32</sup>

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<sup>28</sup> . [1983] 2 NSWLR 157.

<sup>29</sup> . Ibid, at 208.

<sup>30</sup> . [1998] 1 Ch 1.

<sup>31</sup> . Ibid, at 18.

<sup>32</sup> . *Queensland Mines Ltd v Hudson* (1978) 52 ALJR 399 at 401 (per Lord Scarman, in delivering the advice of the Privy Council).

According to the “representative element” of a fiduciary relationship that a person acts for the interest of another and not for his/her own, there are many fiduciary relationships. It is not possible to enumerate exhaustively the different types of fiduciary relationships, but it is not difficult to list the following typical fiduciary relationships: trustee and beneficiary; guardian and ward; employee and employer; partner and partner; agent and principal: solicitor and client; director and company; promoter and company; joint venturers; and so on. Where a fiduciary breaches his/her duty of avoid the conflict between his/her duty and interest and make a profit, he/she may be imposed on a constructive trust and account on the profit he/she has obtained in breach of his/her duty of a fiduciary.

Because there is no concept of fiduciary relationships in China, the duties of the fiduciary-like persons cannot be provided by law collectively and completely. For example, although some scholars think that an agent is under a duty of loyalty to his/her principal,<sup>33</sup> neither the Chinese GPCL nor the Chinese *Contract Law* imposes such a duty to the agent. Also, the Chinese *Law for Lawyers* only provides that a lawyer cannot act as the agent for both sides of the parties to the same case.<sup>34</sup> Again, Chinese *Company Law* considers that a director or a manager of a company is not permitted to create an actual conflict between his/her duties and interests, but the *Company Law* does not provide directly the director or the manager is under a duty not to place himself/herself in a position where his/her duties and his/her interest may conflict; rather, the *Company Law* provides: “Where a director or a manager of a company, in violation of this Law, engages in, by himself/herself or for a third party, a business which is the same as that of the company, the income derived therefrom shall belong to the company. In addition, the company may impose a disciplinary

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<sup>33</sup> . Jiang Ping, Li Yongjun & Li Kaiguo: *The Civil Law* (2000), p 261.

<sup>34</sup> . The Chinese *Law for Lawyers*, article 34.

punishment upon him/her.”<sup>35</sup> It can be said that not to provide for fiduciary relationships is a major deficiency of the Chinese legislation.

There is no concept of fiduciary relationships; there cannot be clear-cut and specific duties imposed on the fiduciary-like persons and there cannot be the effective ways to prevent the fiduciary-like persons from making profits by using their positions. It is suggested that since there is now a Chinese *Law of Trusts*, it is opportune for China to develop a concept of fiduciary relationships according to the duties imposed on a trustee by the Chinese *Law of Trusts*. So long as fiduciary relationships are recognized by the law, where a fiduciary breaches his/her duties as a fiduciary and makes profits, a constructive trust will be imposed on him/her to hold the profit for the beneficial enjoyment of the constructive beneficiary. Meanwhile, if the Common Law notion of fiduciary duties is introduced into China, the Chinese *Law of Trusts* will function more fairly and efficiently.

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<sup>35</sup> . The Chinese *Company Law*, article 215.

# **Appendix**

## **THE LAW OF TRUSTS OF THE PEOPLE'S REPUBLIC OF CHINA**

**(Promulgated at the twenty-first session of the Ninth National  
People's Congress on April 28, 2001)**

### **CONTENTS**

**Chapter I General Provisions**

**Chapter II Creation of a Trust**

**Chapter III Trust Property**

**Chapter IV Trust Parties**

**Division 1 Settlor/Testator**

**Division 2 Trustee**

**Division 3 Beneficiary**

**Chapter V Variation and Termination of a Trust**

**Chapter VI Charitable Trusts**

**Chapter VII Supplementary Provisions**

## **Part I General Provisions**

**Article 1.** This law is formulated to adjust the trust relationship, to regulate the trust act, to protect the lawful rights and interests of the trust parties, and to improve the sound development of Chinese trust business.

**Article 2.** The "trust" within the meaning of this law shall signify that a settlor/testator, on the basis of trusting a trustee, mandates his/her property rights to the trustee who, according to the will of the settlor/testator, administers or disposes of the property in his/her own name for the interest of the beneficiary or for other specific purpose.

**Article 3.** This law shall apply to civil, business and charitable trust activities of the settlor/testator, the trustee and the beneficiary (who shall be named as trust parties in the following articles) within the People's Republic of China.

**Article 4.** Where the trustee conducts the trust activities in the form of a trust institution, the organization and management of the trust institution shall be governed by the regulations enacted by the State Council.

**Article 5.** While undertaking trust activities, trust parties must observe laws and administrative rules, observe the principles of voluntariness, fairness, honesty and good faith, and must not infringe the interests of the state and the public.

## **Part II Creation of Trust**

**Article 6.** The purpose or purposes of creating a trust must be lawful.

**Article 7.** (1) The trust property must be certain and the property must be the lawful property of the settlor/testator before the creation of the trust.

(2) The "property" within the meaning of this law includes lawful property rights.

**Article 8.** (1) The creation of a trust must be in writing.

(2) The written formalities comprise trust contracts, wills or other written instruments prescribed by laws or by administrative regulations.

(3) Where a trust is created by a trust contract, the trust is created when the trust contract is signed by the trust parties. Where a trust is created by other written instruments, the trust is created when the trustee accepts the trust.

**Article 9.** (1) The written instrument creating a trust must clearly state the following terms:

- (a) the purpose or purposes of the trust;
- (b) the names and addresses of the settlor/testator and the trustee;
- (c) the beneficiary or the class of beneficiaries;
- (d) the range, type and the condition of the trust property;
- (e) the methods by which the beneficiary obtains the beneficial interest.

(2) In addition to the provisions of the preceding paragraph, the written instruments may state the period of the trust, the methods of managing the trust property, the remuneration of the trustee, the methods of selecting a new trustee or new trustees, the causes of the termination of the trust, and so on.

**Article 10.** (1) Where the trust property is required to be registered by relevant laws or administrative regulations, it must be registered.

(2) Where the registration has not been carried out in accordance with the preceding paragraph, it must be re-registered. The trust cannot take effect unless the re-registration has been effected.

**Article 11.** A trust shall be void in any of the following circumstances:

- (1) the purpose or purposes of the trust violate laws and administrative regulations or infringe the interests of the public;
- (2) the trust property is uncertain;

- (3) the settlor/testator creates the trust with illegal property or property which is prohibited to be trust property by this law;
- (4) the trust is created for the exclusive purpose of litigation or of demanding the payment of debts;
- (5) the beneficiary or the class of the beneficiaries is uncertain;
- (6) other circumstances prescribed by laws and administrative regulations have occurred.

**Article 12.** (1) Where a settlor/testator has created a trust which is prejudicial to the interest of his/her creditor, the creditor may apply to the court to rescind the trust.

(2) The rescission made by the court pursuant to the provisions of the preceding paragraph shall not affect the benefits which a bona fide beneficiary has already received.

(3) The right of application for rescission shall be extinguished if the creditor does not exercise it within one year from the day when he knows or should have known the reason for rescission.

**Article 13.** (1) A trust by will shall be created in accordance with the relevant provisions of the Law of Succession.

(2) Where a trustee appointed by the will refuses to be the trustee or is unable to be a trustee, a new trustee or new trustees shall be appointed by the beneficiary; if the beneficiary is not *sui juris*, a new trustee or new trustees shall be appointed by the guardian of the beneficiary. Where it is otherwise provided by the will, such provisions shall prevail.

### **Part III Trust Property**

**Article 14.** (1) The trust property means property acquired by a trustee through accepting the trust.

(2) Any property obtained by the trustee, through administering and disposing of the trust property, or through conducting trust affairs, shall form part of the trust property.

(3) Property whose transferability is prohibited by laws and administrative regulations cannot constitute trust property.

(4) Property whose transferability is restricted by laws or administrative rules cannot constitute trust property, unless the transferability has been permitted by the relevant authorities.

**Article 15.** Trust property shall be separated from other property owned by the settlor/testator. Where a settlor dies, is dissolved or is disbanded in accordance with law, or is declared bankrupt after he/she created a trust, if the settlor is the sole beneficiary, the trust shall be terminated and the trust property shall appertain to his/her legacy or property in liquidation; if the settlor is not a beneficiary, the trust shall not be terminated, nor shall the trust property appertain to his/her legacy or property in litigation. Where the settlor, who is one of the beneficiaries, dies, is dissolved or is disbanded in accordance with law, or is declared bankrupt, the beneficial interest of the settlor shall be deemed as his/her legacy or property in liquidation.

**Article 16.** (1) Trust property is distinct from the trustee's own property (which will be named as trustee's individual property in the following articles) and it does not belong to trustee's individual property or part of trustee's individual property.

(2) Where a trustee dies, is dissolved or is disbanded in accordance with law, or is declared bankrupt, the trust property shall not appertain to his/her legacy or property in liquidation.

**Article 17.** (1) Except in the following circumstances, no compulsory execution shall be levied on the trust property:

- (a) the creditor had a proprietary right to the trust property before the trust is created and the creditor exercises it in accordance with law;  
or
- (b) the debts have arisen in the course of conducting trust activities by the trustee and the creditor demands the payment of the debts; or
- (c) the taxes the trustee has incurred in relation to the trust property; or
- (d) any other circumstances provided by law have occurred.

(2) The settlor, the trustee, or the beneficiary may raise objection to the court against the compulsory execution made in contravention of the provisions of the preceding paragraph.

**Article 18.** (1) No set-off shall be effected between the property rights obtained by virtue of administering or disposing of the trust property by the trustee and the debts incurred by the trustee in relation to his/her individual property.

(2) No set-off shall be effected between the property rights and debts incurred by the trustee by virtue of administering and disposing of the trust properties of different trusts.

## **Part IV Trust Parties**

### **Division 1 Settlor/Testator**

**Article 19.** A settlor/testator must be a natural person who is of full legal capacity, a juristic person, or an organization established in accordance with laws.

**Article 20.** (1) A settlor is entitled to inspect, note down, or copy trust accounts of the trust property and other documents in relation to the conduct of the trust affairs.

(2) The settlor is entitled to know the revenue and the expenditure, the administration and disposal of the trust property, and to demand the explanation from the trustee of the conduct of the trust affairs.

**Article 21.** Where the methods of administering the trust property have become inappropriate for the purpose of the trust or inappropriate for the benefits of the beneficiary by reason of special circumstances which could not be foreseen at the time of creating the trust, the settlor is entitled to demand that the trustee adjust the methods of administering the trust property.

**Article 22.** (1) Where a trustee has inflicted losses upon the trust property by reason of mismanagement or by reason of disposing of the trust property in violation of the duty of a trustee, the settlor is entitled to apply to the court to rescind the act of the trustee and demand of the trustee the indemnification of losses or the restitution of trust property. If the transferee has known that he/she has received the trust property in violation of the purpose of the trust, he/she shall return the trust property that he/she has already received or indemnify the losses.

(2) The right of the rescission provided by the preceding paragraph will be extinguished within one year from the day when the settlor knows or should have known the reasons for the rescission.

**Article 23.** Where a trustee disposes of the trust property in violation of the purpose of the trust, or administers or disposes of the trust property with gross negligence, the settlor is entitled to dismiss the trustee in accordance with the terms of the trust instrument or apply to the court to dismiss the trustee.

## **Division 2 Trustee**

**Article 24.** (1) A trustee must be a natural person who is of full legal capacity or a juristic person.

(2) Where the qualifications of being a trustee are otherwise provided by laws and administrative regulations, such provisions shall prevail.

**Article 25.** (1) A trustee must conduct trust affairs for the optimal benefit of the beneficiary in accordance with the trust instrument.

(2) The trustee administering the trust property is subject to the duties of loyalty, honesty, fidelity, scrupulousness and efficiency.

**Article 26.** (1) Apart from obtaining the remuneration in accordance with this law, a trustee cannot make use of the trust property for his/her own benefit.

(2) Where the trustee makes use of the trust property for his/her own benefit in violation of the provisions of the preceding paragraph, the benefits he/she has obtained shall form part of the trust property.

**Article 27.** A trustee cannot convert the trust property into his/her individual property. Where the trustee has converted the trust property as his/her individual property, he/she must restore the trust property or indemnify the losses caused by him/her.

**Article 28.** (1) A trustee shall not conduct transactions between the trust property and his/her individual property or conduct transactions between the trust properties of different trusts, except where it is otherwise provided by the trust instrument or where it has been approved by the settlor or by the beneficiary, and that such transactions have been conducted in accordance with the market price.

(2) Where the trustee has inflicted losses upon the trust property in contravention of the provisions of preceding paragraph, he/she shall bear the liability of indemnification.

**Article 29.** A trustee shall keep separate accounts of the trust property and his/her individual property and administer the properties separately. The trustee shall also keep separate accounts of the trust properties of different trusts and administer these trust properties separately.

**Article 30.** (1) A trustee shall conduct trust affairs personally; however, he/she may delegate the trust affairs to a third person if it is otherwise provided in the trust instrument or there exist compelling reasons for delegation.

(2) Where the trustee delegates the trust affairs to a third person, the trustee shall be liable for the trust act of such a person.

**Article 31.** (1) Where there are two or more than two trustees in a trust, they are co-trustees.

(2) Co-trustees shall conduct trust affairs jointly except where it is otherwise provided in the trust instrument.

(3) Where the co-trustees disagree with one another in conducting the trust affairs, they shall conduct the trust affairs in accordance with the trust instrument; where there are no such provisions in the trust instrument, they shall conduct the trust affairs in accordance with the decisions made by the settlor, the beneficiary, or the interested person.

**Article 32.** (1) The co-trustees shall assume the joint and several liabilities to the debts owed to a third party incurred in conduct of the trust affairs. The declaration of intention made by a third party to any of the co-trustees is effective to other co-trustees.

(2) Where one of several trustees has inflicted loss upon the trust property in violation of the purpose of the trust, through mismanagement or other breach of duty, the co-

trustees shall be jointly and severally liable with the first-mentioned trustee for that loss.

**Article 33.** (1) A trustee shall keep a complete record of the conduct of trust affairs.

The trustee shall apprise the settlor and the beneficiary of the management and disposal of the trust property, and of the revenue and expenditure regularly once a year.

(2) The trustee shall, in accordance with the law, assume the duty of confidentiality in relation to the settlor, the beneficiary, the trust affairs and the trust documents.

**Article 34.** A trustee assumes the duty to pay the beneficiary the beneficial interest to the extent of the trust property.

**Article 35.** (1) A trustee is entitled to remuneration in accordance with the trust instrument. Where there is no such provision in the trust instrument, the trust parties may supplement the agreement by providing for the remuneration. The trustee cannot obtain remuneration for conducting trust affairs if there is no such agreement prior to or after the creation of the trust.

(2) The trust parties may increase or decrease the amount of remuneration by negotiation.

**Article 36.** Where a trustee has inflicted losses upon the trust property by virtue of violating the purpose of trust, the breach of the duty of administration, or mismanagement, he/she cannot demand the remuneration before he/she has indemnified the losses or restored the trust property.

**Article 37.** (1) The expenses and the debts owed to a third party incurred in the execution of the trust shall be paid or discharged out of the trust property. Where the trustee has paid the expenses and the debts out of his/her individual property, he/she is

entitled to reimburse himself/herself out of the trust property in preference to other persons.

(2) Where the trustee has incurred any debts or suffered any losses by virtue of the breach of his/her duty of administration or his misconduct of trust affairs, the trustee shall pay the debts or bear the losses out of with his/her individual property.

**Article 38.** (1) After a trust is created, the trustee may resign from his/her office with the consent of the settlor and the beneficiary. If the resignation of the trustee of a charitable trust is otherwise provided by this law, such provisions shall prevail.

(2) Where the trustee resigns from his office, he/she shall continue to conduct the trust affairs until the new trustee is appointed.

**Article 39.** (1) In any of the following circumstances, the office of a trustee shall terminate:

- (a) the trustee dies or is declared dead;
- (b) the trustee is declared as a person without full legal capacity or only with limited capacity;
- (c) the trustee is dissolved or declared bankrupt in accordance with the law;
- (d) the trustee is dissolved or loses its legal qualifications as a trustee;
- (e) the trustee resigns from his office or is dismissed;
- (f) other circumstances provided by laws and administrative regulations have occurred.

(2) Where the office of the trustee terminates, the heir, the administrator of the legacy, the guardian, and the liquidator of the trustee shall keep in custody the trust property and assist the new trustee to take over the trust affairs.

**Article 40.** (1) When the office of a trustee terminates, the new trustee shall be appointed in accordance with the trust instrument. Where there are no such provisions in the trust instrument, the new trustee shall be appointed by the settlor; where the settlor is unable or unwilling to appoint a new trustee, the new trustee shall be appointed by the beneficiary; where the beneficiary is of no legal capacity or is of limited legal capacity, the new trustee shall be appointed by the guardian of the beneficiary.

(2) The rights and duties of the former trustee shall be taken over by the new trustee.

**Article 41.** (1) Where the office of a trustee terminates by virtue of circumstances provided in Article 39 paragraph 1 (3) to (6) of this law, the trustee shall make a report of the conduct of the trust affairs, transfer the trust property to the new trustee, and devolve the trust affairs to the new trustee.

(2) Where the report mentioned in the preceding paragraph has been accepted by the settlor or the beneficiary, the responsibilities of the former trustee stated in the report shall be relieved by such acceptance, except where the former trustee has committed any dishonest acts.

**Article 42.** Where the office of one of several trustees terminates, the trust property shall be administered by the other co-trustees.

### **Division 3 Beneficiary**

**Article 43.** (1) A beneficiary is the person who is entitled to the beneficial interest in a trust. A beneficiary may be a natural person, juristic person or an organization established in accordance with laws.

(2) A settlor may be one of the beneficiaries or may be the sole beneficiary of a trust.

A trustee may be one of the beneficiaries, but she/she cannot be the sole beneficiary of a trust.

**Article 44.** A beneficiary is entitled to the beneficial interest on the day when the trust takes effect except where it is otherwise provided by the trust instrument.

**Article 45.** Co-beneficiaries are entitled to the beneficial interest in accordance with the trust instrument. Where there are no provisions for the apportionment of the trust property or methods for the distribution of the beneficial interest in the trust instrument, the co-beneficiaries are entitled to the beneficial interest equally.

**Article 46.** (1) A beneficiary may disclaim his/her right to the beneficial interest.

(2) A trust will be terminated when all the beneficiaries disclaim their rights to the beneficial interest.

(3) Where some of beneficiaries disclaim their rights to the beneficial interest, these disclaimed interests will belong to the persons according to the following order:

- (a) the person who is nominated in the trust instrument;
- (b) other beneficiary or beneficiaries;
- (c) the settlor or his/her heir.

**Article 47.** Where a beneficiary cannot pay his/her due debts, he/she may pay the debts with beneficial interest, except that it is otherwise provided by the trust instrument, or it is limited by the laws and administrative regulations.

**Article 48.** A beneficiary's beneficial interest may be transferred or succeeded to in accordance with law, except that it is otherwise provided in the trust instrument.

**Article 49.** (1) A beneficiary is entitled to the rights of a settlor provided from Article 20 to Article 23 of this law. Where the beneficiary has disagreements with the settlor in exercising the aforesaid rights, they may apply to the court to make a verdict.

(2) Where one of the co-beneficiaries applies to the court to rescind an act of the trustee listed in the first paragraph of Article 22, the rescission decision made by the court upon the application of the beneficiary is effective in relation to all the co-beneficiaries.

## **Part V Modification and Termination of Trust**

**Article 50.** Where a settlor is the sole beneficiary, he/she or his/her heir may revoke the trust except where it is otherwise provided by the trust instrument.

**Article 51.** (1) After a trust is created, the settlor may change the beneficiary or dispose of the beneficial interest of the beneficiary under any of the following circumstances:

- (a) the beneficiary has committed gross tort in relation to the settlor;
- (b) the beneficiary has committed gross tort in relation to other co-beneficiaries;
- (c) it is agreed to by the beneficiary;
- (d) it is otherwise provided for in the trust instrument.

(2) The settlor may revoke the trust under the circumstances of (1), (3) and (4) of the preceding paragraph.

**Article 52.** Except where it is otherwise provided by this law or by the trust instrument, a trust shall not be terminated by virtue of the fact that the settlor or the trustee dies, loses legal capacity, is dissolved or is disbanded in accordance with laws, or is declared bankrupt, nor shall it be terminated by virtue of the resignation of the trustee.

**Article 53.** A trust shall be terminated under any of the following circumstances:

- (1) the causes of termination specified in the trust instrument have occurred;
- (2) the continuance of the trust will violate the purpose of the trust;
- (3) the aim of the trust has been achieved or has become impossible to be achieved;
- (4) the parties to the trust agree to terminate the trust;
- (5) the trust has been rescinded;
- (6) the trust has been revoked.

**Article 54.** Upon the termination of a trust, the trust property shall vest in the person designated in the trust instrument; where there is no such designated person in the trust instrument, the trust property shall vest in the persons in accordance with the following order:

- (1) the beneficiary or his/her heir;
- (2) the settlor or his/her heir.

**Article 55.** Pending the transfer of the trust property to the person in accordance with the preceding Article, the trust shall be deemed to continue to exist and such person shall be deemed as the beneficiary.

**Article 56.** After a trust is terminated, the compulsory execution levied on the trust property of the terminated trust by the court in compliance with Article 17 of this law shall be made against the person who has received the trust property.

**Article 57.** When a trustee exercises his/her right to remuneration and reimbursement out of the trust property in accordance with this law after the trust has been terminated, he/she may detain the trust property or demand from the beneficiary such remuneration and the reimbursement.

**Article 58.** Upon the termination of a trust, the trustee shall make a liquidation report on trust affairs. If the beneficiary or the person in whom the trust property is vested has no objections to the report, the trustee shall be exonerated from the responsibility of his/her office, except where the trustee has committed any dishonest acts.

## **Part VI Charitable Trust**

**Article 59.** This part shall apply to charitable trusts. If there are no provisions in this part applicable to charitable trusts, the other parts of this law or relative stipulations of other laws shall be applied.

**Article 60.** A trust created for the following purposes of public interest is a charitable trust:

- (1) the relief of poverty; or
- (2) the relief of victims of natural calamities; or
- (3) the providing of assistance to the disabled; or
- (4) the advancement of education, science and technology, culture, arts and sports; or
- (5) the advancement of medical and hygienic business; or
- (6) the advancement of the business of maintenance and protection of ecological environment; or
- (7) the advancement of any other public interest.

**Article 61.** The state encourages the development of charitable trusts.

**Article 62.** (1) The creation of a charitable trust and the appointment of the trustee shall be approved by the administrative organization of charitable business (it will be named as the administrative office in the following articles).

(2) Without the approval of the administrative office, no one can conduct activities in the name of a charitable trust.

(3) The administrative office shall support the activities of charitable trusts.

**Article 63.** The property and the income thereof of a charitable trust cannot be applied to a non-charitable purpose.

**Article 64.** (1) A trust curator shall be appointed for a charitable trust.

(2) The trust curator shall be appointed by the trust instrument; if there are no such provisions in the trust instrument, the trust curator shall be appointed by the administrative office.

**Article 65.** A trust curator has the right to bring an action to the court or to take other juristic acts in his/her own name so as to protect the interest of the beneficiary.

**Article 66.** The trustee of charitable trust shall not resign from his/her office without the permission of the administrative office.

**Article 67.** (1) The administrative office shall inspect the conduct of the trustee of a charitable trust and the status of the trust property.

(2) The trustee shall, at least once a year, make a report on the conduct of the charitable trust affairs and on the status of trust property, and give a public announcement of the report after it has been agreed by the trust curator and approved by the administrative office.

**Article 68.** Where a trustee of a charitable trust breaches his/her duty or is unable to perform his/her duties, the administrative office shall replace the trustee.

**Article 69.** Where certain circumstances, which could not be foreseen at the time of the creation of a charitable trust, have occurred after the charitable trust had been created, the administrative office may modify the relative terms of the trust instrument in accordance with the purpose of the charitable trust.

**Article 70.** Where a charitable trust is terminated, the trustee shall apprise the administrative office of the causes and the date of termination within 15 days from the day when the causes of termination have occurred.

**Article 71.** Where a charitable trust is terminated, the trustee shall make a liquidation report on the conduct of the charitable trust affairs, and give a public announcement of the report after it has been agreed by the trust curator and approved by the administrative office.

**Article 72.** Upon the termination of a charitable trust, if there are no designated persons who are entitled to have the trust property vested in them as owners or such designated persons are members of the public who are not specified persons, with the approval of the administrative office, the trustee shall apply the trust property to a purpose, which is similar to the original purpose of the charitable trust, or transfer the trust property to another charitable organization or another charitable trust, of which the purpose is similar to the original purpose of the charitable trust.

**Article 73.** Where the administrative office violates this law, the settlor, the trustee and the beneficiary has the right to sue the administrative office in court.

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**Article 74.** This law shall take effect as from October 1, 2001.

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