Overview of China Trust Law

Description

Does China has its own version of trust law? Many may not have a ready answer.

Yes, China does have its own Trust Law enacted back in 2001. This post will summarize the main provisions and talk about the main issues.

1. Definition of Trust

Article 2 of the Law provides for the definition of trust:

> "For purposes of this Law, trust refers to that the settlor, based on his faith in trustee, entrusts his property rights to the trustee and allows the trustee to, according to the will of the settlor and in the name of the trustee, administer or dispose of such property in the interest of beneficiary or for any intended purposes."

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It is quite big a bravery for China legislature to give a definition to trust, which does not even appear in any legislation in UK or USA where trust originated. Instead, Anglo-saxon legal experts had offered various version of descriptive definitions to trust, for example:

> A trust is where a person transfers the legal ownership of property to another to hold that property for the benefits of somebody else.

By contract, one can discern that a fundamental difference between the two definition: in China's version, trust properties is simply "entrusted" to the trustee without making it clear (most likely, intentionally left in ambiguity) whether legal title has thereby transferred to the trustee and indeed, some trust scholars argued that under China Trust Law, the title of the trust properties does not have to be transferred. This probably makes China trust no longer a trust in the perception of Anglo-Saxon trust professionals.

The reason why China has adopted such a weird definition is because of the ownership doctrine in civil law jurisdictions. You may wish to read another post on the blog for more: A New Understanding of Trust Laws-Close the Gap between Civil and Common Law Systems.

2. Types of Trusts

Article 3 of China Trust Law provides for civil trust, commercial trust (*Yingye Xintuo in Chinese Pinyin*) and public welfare trust (or charitable trust).

Unlike in Anglo-Saxon jurisdictions where trusts are most employed in family settings as an effective estate planning tool, civil trusts (referring to trusts in family context) are rarely used in practice and instead commercial trusts have staged a spectacular landscape in China's financial industry where

commercial trusts are used very much as a financing instrument for big engineering and real estate development projects.

Charitable trusts are are as well and are often controlled by government-affiliated agencies.

Other than that, the law does not distinguish other types of trust common in UK or USA, for example, there is no distinction between revocable or irrevocable trusts, inter vivos trust or testamentary trusts in China.

3. Setup of Trusts

In order to set up a trust under China Trust Law:

(1) there must be a legitimate trust purpose;

(2) the trust property must be ascertained and must be legitimately owned by the settlor;

(3) the trust shall be settled in writing including trust contract, will or other forms of writing as mandated by laws and administrative regulations, and these trust documents SHALL contain the following information: trust purpose, names of the settlor, beneficiary or scope of beneficiaries, trust properties (scope, kinds and conditions) and the way or manners beneficiaries receive trust benefits, and MAY include other information such as term of the trust, management of trust properties, remuneration for the trustees, the appointment of new trustee, termination of the trusts.

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It is worthy of a note that the law does not require a certain name for the trust, so the trust does not have any legal personality and won't be taxed as an entity, and won't be able to open an bank account in the trust name. This has a big adverse bearing on the development of trust practice in China.

(4) where, according to the laws or administrative regulations, registration formalities are required in regard of the trust properties, trust registration shall be effected. Otherwise, the trust won't take effect.

The law also lists trusts that would be considered void:

(1) the trust purpose is in violation of the laws, administrative regulations or publish interests;

(2) trust properties are not ascertainable;

(3) the settlor creates the trust on illegitimate properties;

(4) trusts settled only for purpose of lawsuits or debt collection;

(5) beneficiary or scope of beneficiaries are not ascertainable;

(6) other circumstances as provided by the laws and administrative regulations.

Also the law has made it clear that a creditor may sue to court to have the trust revoked if the creation or settlement of the trust has injured the interests of the settlor's creditors. Given those provisions, a trust can be effectively used as an asset protection tool in segregating assets from being exposed to business risks so long as the trust is created at a good time without an intent to avoid debt obligations.

4. Special Provisions on Trust Properties

Trust properties are defined to be (1) the properties (corpus) initially settled with the trustee, and (2) the other properties (income) resulted from the operation, management and disposal of the trust properties.

Despite that China Trust Law does not make it clear in its trust definition as to whether or not the legal ownership of the trust properties shifts to the trustee, the trust does confer the legal status of independence on the trust properties.

(1) Independent of and Separate from the other Properties of the Settlor (Trustor)

Article 15 of the Trust Law provides to the effect that trust properties shall be differentiated from other unsettled properties owned by the settlor, and the trust shall survive the death of the settlor if the settlor is not the only beneficiary and thereby, the trust properties shall not be regarded as part of the estate of the deceased settlor (either individual or body corporate), but however, in this case, the beneficiary right of the settlor shall be part of the estate or liquidated assets of the deceased settlor. In case that the settlor is the only beneficiary of the trust, then the trust properties shall form part of the estate or liquidated assets of the deceased settlor.

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(2) Independent of and Separate from the Properties Owned by the Trustees

Trust properties shall be differentiated from the properties owned by the trustees and shall not be considered as part of the estate or liquidated assets of the trustees when the trustees die or dissolved or are otherwise wound up. Trustees shall not use the creditor rights of the trust to set off the debts incurred on their own properties.

(3) Exemption from Compulsory Enforcement

As a general or default rule, trust properties are free from compulsory enforcement by courts except in the circumstances below:

(i) a creditor has acquired a preferential right (be paid in priority) attached to the trust properties prior to the creation of the trust;

(ii) a creditor requests to have a debt discharged which debt arises from the administration of the trust affairs by the trustees;

(iii) taxes assessed and levied on the trust properties;

(iv) other circumstances provided by laws.

In case of a wrongful compulsory enforcement against the trust properties, the settlor, trustee or

beneficiary shall each have the right to challenge the enforcement with the courts.

5. Parties to Trust

China Trust Law sets out the rights, powers, benefits and obligations vested in each of the settlor, trustee and beneficiary.

(1) Settlor

Settlor Rights	1.right to information about the trust (Article 20): the settlor has the right to learn ab disposal and income and expenses, and may request the trustee to explain such is that, the settlor has the right to check, take excerpts or copy accounting books relat 2. right to require the trustee to adjust the way of managing the trust properties (Art where unexpected events not foreseeable at the time of creation of the trust arise, the attainment of the trust purpose or on the benefits of the beneficiary. 3. the right to ask courts to revoke trustee's act and/or request for compensation ar (Article 22), where the trustee has acted against the purpose of the trust or in breac caused loss to the trust property due to inappropriate disposal. 4. the right to dismiss trustee (Article 23) in accordance with trust documents or rec dismissal where the trustee has disposed of the trust properties against the purpos gross negligence in managing and disposing of the trust properties.

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These provisions of China Trust Law confer upon settlors substantial rights and control over the activities by the trustees that may readily make the trust fail or otherwise categorized as an illusionary trust. In a sense, this is in line with China's legal and cultural traditions where, at laws, property owners have the utmost rights and powers in controlling and dictating the way his properties are dealt with, and in culture, China society does not have that strong tradition of placing much faith in others.

(2) Trustee

2. right to preferential reimbursement for expenses paid by trustees out of his own money (Article 37), being preferential treatment over other creditors over the trust properties.

3. right to lien over trust properties for payment of trustee remuneration and reimbursements upon termination of the trust, as against the final owners for the trust properties.

1. the duty to act in the best interests of the beneficiary pursuant to the trust agreem and effective in management (Article 25);

2. duty to avoid conflict of interests: (i) except for remuneration, shall not make gains (Article 26), (ii) shall not convert the trust properties into his own properties (Article 2 between his own properties with trust properties, or between different trust properties trust agreements or agreed by the granter or beneficiary (Article 28);

3. duty to keep trust properties separate from its own properties and from other trust accounts and separate managements (Article 29);

4. duty to keep full and complete accounts of trust affairs and make reports to settlor of the trust, disposal and expenses and incomes (Article 33);

5. duty to handle trust affairs on its own unless otherwise expressly allowed to deleg documents or justified by exceptional events (Article 30); or shall not resign without t beneficiary and if resigning, shall assume trusteeship till the appointment of new trus

Duties

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6. Duty to keep confidential the status and conditions of the trust affairs and trust documents and materials (Article 33).

It shall be pointed out that China Trust Law has not made it clear whether a settlor can serve as a trustee for the settlor's own properties. While inter vivos trusts or living trusts are very popular in USA where the settlor declares himself as trustee holding properties for others (including settlor himself), it is yet to be tested whether such arrangement will be accepted or recognized under current China Trust Laws. It is my personal opinion that a settlor can declare himself under China Trust laws to hold properties for beneficiaries. In such a case, technically, the problem is how the trust agreement is concluded. Will the same contract as signed by the same one person in two different capacities (as settlor and as trustee) be recognized under China laws? Or simply to recognize a new form of trust documents for settling a trust, namely a self-declaration or statement to that effect?

As the law is not clear, it takes bravery and pioneering spirits to test the ground in practice.

(3) Beneficiary

As a beneficiary, one has no obligations but rights and powers only.

Article 43 of China Trust Law provides that a settlor can be a beneficiary and can be the sole and single beneficiary of the trust he or she sets up, and on the other hand, a trustee can also be a beneficiary but cannot be the sole and single beneficiary of a trust he or she administers.

This is true in that if the trustee and beneficiary are the same person, it is no longer a trust but an outright gift indeed.

According to Article 44, a beneficiary's right under the trust is vested in the beneficiary as of the effectiveness of the trust agreement, except as otherwise stipulated in the trust document. On the other hand, the law provides that a beneficiary can waive his or her beneficiary right, and the waived beneficiary right will be vested in turn in (1) the person stipulated in the trust document, (2) other beneficiaries, and (3) the settlor or its heirs.

Under China Trust Law, a settlor can not only set up a fixed trust but also a discretionary trust according to Article 45 which reads that co-beneficiary shall receive and enjoy the trust benefits according to the contents of the trust documents, and if the trust document fails to stipulate the percentage and methods of disbursements, then the co-beneficiaries shall enjoy the benefits equally. Here the law seems to refrain from interfering with how trust benefits are disbursed under the trust leaving it possible for either fixed trust or discretionary trust to be created.

While spendthrift trust is sometimes still controversial in some jurisdiction, China Trust Law seems to have laid solid ground for its existence. Article 47 provides that a beneficiary's benefits under a trust can be used to pay off his or her debts, except as otherwise limited by the laws, administrative regulations and the **trust document**. In other words, if the settlor makes it explicit that the benefits for the beneficiary shall not be used to discharge the debts of the beneficiary, then the creditors of the beneficiary will no longer be able to enforce their claims against the benefits in the trust.

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Further, Article 48 also allows a trust document to dictate whether a beneficiary right can be assigned or inherited. With the beneficiary right not to be inherited by the beneficiary's heirs, it is also possible to create a lifetime interests for certain beneficiary and then passes that estate on to other people designated by the settlor in the trust document.

What's more, Article 49 of China Trust Law has conferred on the beneficiaries those rights as listed in the table above, meaning that the beneficiary can have access to information of trust affairs, adjust the method of management of the trust, revoke inappropriate action conducted by trustee and fire trustees.

6. Amendments and Termination of Trust

(1) Dissolution of Trust

In the following circumstances, the settlor has the right to end and wind up an ongoing trust:b

i. where the trustor or settlor is the only beneficiary, the settlor or his or her heirs may dissolve the trust, unless otherwise stipulated in the trust document.

ii. where the beneficiary commits serious tortious acts against the settlor, the settlor may dissolve the trust;

iii. where the beneficiary agrees on the dissolution, the settlor can dissolve it;

iv. where the trust document confers the right to change beneficiary or dispose of beneficiary's right under the trust, the settlor may also dissolve the trust.

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(2) Change of Beneficiary

Article 51 of China Trust Law confers upon the trust settlor the power to change or replace trust beneficiary or dispose of the beneficiary's rights to benefits under the trust in the following circumstances:

i. beneficiary commits serious tortious acts against the trust settlor;

ii. one beneficiary commits serious tortious acts against other co-beneficiaries;

iii. with the consent of the beneficiary;

iv. in other circumstances as stipulated in the trust document.

The power to replace or change the beneficiary is virtually the power to rescind or dissolve the trust. So in circumstance i, iii and iv, the settlor may also directly choose to dissolve the trust.

This statutory power granted to the settlor by the law is significant making it easy to revoke a trust by the settlor, esp when there are no clear guidelines to define what constitute "serious tortious acts".

Given the current China legal environment (including rules related to gifts), it will be very difficult for irrevocable trusts of the kind in common law countries to exist in China.

(3) Termination of Trust

Article 53 of China Trust Law provides for the termination of a trust, in the following circumstances:

i. termination events as set out in the trust document arise;

ii. the continuation of the trust runs against its intended purpose;

iii. the trust purpose has been attained or impossible to be attained;

iv. the parties to the trust agree on the termination;

v. the trust is revoked;

vi. the trust is dissolved.

Upon termination of a trust, the estate of the trust shall go to the person designated in the trust documents, failing which, the estate of the trust shall belong to: (i) beneficiary or its heirs, or (ii) settlor or its heirs.

The law also imposes a duty on the trustee to make a liquidation report upon the winding up of the trust, and the trustee is generally freed from its fiduciary duties once the report is passed by the beneficiary or the owners of the trust estate.

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7. Charitable Trust

The law has devoted a separate chapter consisting of 15 clauses on the setup, operation, amendment and termination of charitable trusts.

As charitable trusts are heavily controlled by government, it is not in any sense similar to private trusts. This post won't deal with charitable trust in more details.

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