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# The Chinese Law of Trusts - A Compromise Between Two Legal Systems

## **Abstract**

The Chinese legal system, which stems from the Civil Law System, is quite different from that of the Common Law System with its duality of Common Law and Equity. Trusts have been developing as part of Equity for centuries and they have become the most important institution of Equity. In the course of accepting and transplanting trusts into China, Chinese law drafters had to face the conflicts between the two different legal systems and they made a compromise by accepting the trust concept from the Common Law countries in order to mingle it with the Chinese civil law legal system, and to let it function optimally in China.

To understand the Chinese Law of Trusts deeply and to understand what compromises have been made, an outline of that Law will be introduced, followed by a comparative study of the Chinese Law of Trusts and the law of trusts in the Common Law countries, such as Australia, Britain and the United States.

## **Keywords**

People's Republic of China, Law of Trusts, trusts, civil law, common law

## **Cover Page Footnote**

Many thanks to Professor John Farrar for encouraging me to write this article and many thanks to Associate Professor Denis Ong for academic guidance.

# THE CHINESE LAW OF TRUSTS - A COMPROMISE BETWEEN TWO LEGAL SYSTEMS \*

*Zhenting Tan*<sup>+</sup>

## **Introduction**

The Chinese Law of Trusts, which, since August 1993, China had engaged experts and scholars to draft, was enacted on April 28<sup>th</sup>, 2001, in the 21st session of the Standing Committee of the Ninth Chinese National People's Congress, after the drafts of the law had been revised three times. The Law came into force on October 1<sup>st</sup>, 2001. The Law has a total of 74 articles and is divided into seven chapters, namely General provisions, Creation of Trusts, Trust Property, Trust Parties, Variation and Termination of Trusts, Charitable Trust, and Supplementary Provisions.

The Chinese legal system, which stems from the Civil Law System, is quite different from that of the Common Law System with its duality of Common Law and Equity. Trusts have been developing as part of Equity for centuries and they have become the most important institution of Equity. In the course of accepting and transplanting trusts into China, Chinese law drafters had to face the conflicts between the two different legal systems and they made a compromise by accepting the trust concept from the Common Law countries in order to mingle it with the Chinese civil law legal system, and to let it function optimally in China.

To understand the Chinese Law of Trusts deeply and to understand what compromises have been made, an outline of that Law will be introduced, followed by a comparative study of the Chinese Law of Trusts and the law of trusts in the Common Law countries, such as Australia, Britain and the United States. But first of all, it will be helpful to give the history of the making of the Chinese Law of Trusts.

## **The History of the Making of the Chinese Law of Trusts**

The history of the making of the Chinese Law of Trusts was filled with drama. The process of law-making was divided into two stages and the task was given to

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two different drafting bodies, which represented the different guiding ideologies which were reflected in the great changes made to the drafts of the trusts law in China during these two different stages. The first stage began in August 1993 and ended in December 1996.

Since the 1990s, Chinese economic growth has developed fast, coupled with the rapid development of the business trust. By the end of 1995, the trust investment companies in China had multiplied to 392, with a total capital of 600 billion yuan Chinese RMB.<sup>1</sup> The development of trust businesses in China has played a great role in removing the deficiencies of the banking system, in utilizing socially idle capital, in absorbing foreign capital, in widening the channels of investment and in promoting the development of the market economy. However, these trust investment companies have encountered some problems, such as the uncertainty of their business range and of their legal status, the serious breaches of business regulations, the unsoundness of capital structure, the inefficiency in controlling market risk, and the grossly inadequate self-regulation that resulted in chaotic management.<sup>2</sup> To solve these problems, the suggestion of enacting a law of trusts was presented and listed in the legislation plan of the Eighth Chinese National People's Congress of China. The Economic Committee of the Standing Committee of the Chinese National People's Congress had been engaging experts and scholars to draft the law of trusts in China since August 1993. They spent three years in doing so and finished the first draft at the end of 1996. This draft had 125 articles and was divided into six chapters: General Provisions, Trust Relationship, Charitable Trust, Trust Companies, Legal Liabilities and Supplementary Provisions. The guiding philosophy of the draft was to resort to legal means to regulate trusts, to intensify the supervision and management of trust businesses and to promote the sound development of Chinese trust businesses. This draft was examined in the 23rd session of the Standing Committee of the Eighth Chinese National People's Congress in December 1996, but it was rejected because it contained too many controversial propositions.

The second stage of making the law of trusts lasted from the end of 1996 to April 2001. After the failure of the first draft of the law of trusts to win approval, the drafting task was transferred from the Economic Committee to the Legal Committee of the Standing Committee of the Chinese National People's Congress. The second drafting group spent four years in preparing the second draft of the law of trusts which was completed in June 2000. This draft, which had provisions on only the basic concepts of trusts, deleted the parts relating to trust businesses and readjusted its structure as follows: Chapter one, General Provision; Chapter two, Creation of Trusts; Chapter Three, Trust Property; Chapter Four, Trust Parties; Chapter Five, Variation and Termination of Trusts; Chapter Six, Charitable Trusts; Chapter Seven, Supplementary Provisions. According to the explanation given by the spokesman for the Legal Committee, there were three

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1 *The Law of Trusts in the People's Republic of China* (2001) 21.

2 *Ibid* 22.

reasons for deleting the provisions relating to trust businesses. Firstly, the Chinese government had been administering and standardizing trust companies since 1997, yet it was not then ready to regulate trust companies by a law of trusts. Secondly, a further study on how to regulate the range of trust companies should first be made, and this had not been done. Again, because in China the law of trusts would operate under the civil law, it was more reasonable to provide only for the basic concepts of trusts in the Chinese Law of Trusts. As far as the supervision and administration of trust businesses were concerned, it was decided to carry out further studies.<sup>3</sup>

The second draft of the law of trusts was presented for examination to the 16th session of the Standing Committee of the Ninth Chinese National People's Congress in July 2000 and was again rejected in that some members of the committee disagreed with one another on some aspects of the draft.

In accordance with the suggestions made by the examiners of the second draft, the Legal Committee began to revise the second draft and finished the third draft a year later. On April 28<sup>th</sup>, 2001, in the 21st session of the Standing Committee of the Ninth Chinese National People's Congress, the third draft of Chinese Law of Trusts was enacted and came into force on October 1<sup>st</sup>, 2001.

After the second draft of the law of trusts had been rejected, the Chinese People's Bank made Regulations on the Management of Trust and Investment Companies while the third draft of the law of trusts was being prepared. The Regulations, with eight chapters and 78 articles, came into force on January 19<sup>th</sup>, 2001. The basic concepts, the legal terminology and the principles of trusts law used by the Regulations have been borrowed from the second draft of the Chinese law of trusts. The Regulations became an impetus to the enactment of the Chinese Law of Trusts.

The first stage of making the Chinese law of trusts, which was not undertaken by the Legal Committee of Standing Committee of the Chinese National People's Congress, whose main task is to make laws, was undertaken by the Economic Committee, whose function is not to make laws. This shows that the law of trusts has not been given much attention by China and that the purpose of enacting a law of trusts was just to supervise and administer the trust companies in China. During the second stage of making the Chinese law of trusts, the Legal Committee adopted the experiences of Japan and Taiwan, which had legislated their law of trusts and law of trust businesses respectively. They deleted the regulations on trust businesses in the second and third drafts of law of trusts, but added one article, namely article 4. This article provides that the regulations on supervision and management of the trustee, which conducts trust activities in the form of trust organization, shall be regulated by the State Council of China.

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3 Ibid 29.

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The view of the Legal Committee is correct. It is not pragmatic in China to make a law which regulates trusts as well as trust companies, because the supervision and management of Chinese trust companies are likely to change with the economic reforms in China. Furthermore, the trust companies are not really companies which engage in the business of administering trusts. Again, the law of trusts is not only unfamiliar to Chinese people, but also unfamiliar in Chinese legal circles. To legislate for a law of trusts without regulations on trust companies is more appropriate for the Chinese legal system. In addition, although the Regulations on the Management of Trust and Investment Companies are only administrative rules at present, they will be made into legislation in the future, namely there will be a law of trust businesses, when it becomes necessary to do so. When that time comes, the law of trusts and the law of trust businesses will push the Chinese economy forward together.

### **The Outline of the Chinese Law of Trusts**

The Chinese Law of Trusts comprises seven chapters and 74 articles. The first chapter is General Provisions which has 5 articles. It stipulates the purpose of this law, the concept of trust, the adjusting range of this law and the basic principles that should be followed in trust activities. The purpose of making the Chinese law of trusts is stipulated in article 1 as follows: 'This law is formulated to adjust the trust relationship, to regulate trust acts, to protect lawful rights and interests of the trust parties, and to improve the development of Chinese trust business.' Article 2 provides the concept of trust as:

The 'trust' within the meaning of this law shall signify that a settlor/testator, on the basis of trusting a trustee, vests his/her property rights in the trustee who administers or disposes of the trust property according to the interests of the beneficiary or for other specific purpose or purposes.

The range of this law, according to article 4, covers civil trusts, business trusts and charitable trusts. The basic principles of this law are borrowed from the Chinese civil law. Article 5 provides that: 'while undertaking trust affairs, trust parties must observe laws and administrative rules, observe the principles of voluntary, fairness, honesty and good faith, and must not infringe upon the interests of the state and the public.'

Chapter two, which deals with the creation of a trust has 8 articles (from article 6 to article 13). It provides for the conditions for and methods of creating a trust, for the three certainties for the creation of a trust and invalid trusts. It emphasizes the written formalities as well as the lawful trust purpose for creating a trust. Article 6 provides that: 'To create a trust requires the lawful trust purpose'. Article 8 clearly provides that: 'The creation of a trust shall be effected in writing. The written formalities include trust contract, will or other written instruments stipulated by laws or by administrative rules....'

Article 11 provides for void trusts such as trusts lacking one of three certainties, trusts for the purpose of litigation or for demanding the payment of debts. This article also provides that a trust will be void if the circumstances, which are stipulated by other laws and administrative rules and can result in the invalidity of the trust, have occurred. Again, Article 12 provides that the creditor of the settlor/testator may apply court to revoke a trust if it is to be prejudicial to the interests of him/her. In addition, Article 13 provides that 'a trust by will shall be created in compliance with the relative provisions of the law of succession.'

Chapter three, which has 5 articles (from article 14 to article 18) are provisions concerning trust property. Article 14 defines the range of trust property. It provides that the trust property refers to property obtained by a trustee through accepting the trust, and any property obtained by the trustee through managing on, disposing of trust property or through other means shall be deemed as trust property. It also provides that property whose transferability is prohibited cannot constitute trust property, and that property whose transferability is restricted cannot be created as trust property unless it has been approved by the relevant authorities. This chapter explicitly stipulates that trust property is distinct from the trustee's own property and that the trust property shall be set apart from the property owned by the settlor/testator.<sup>4</sup> Furthermore, no set-off shall be effected between the rights obtained by virtue of managing or disposing of trust property by the trustee and the obligations pertaining to the trustee's own property. Also, no set-off shall be effected between the rights and obligations pertaining to the management and disposal of trust properties of different settlors by the trustee.<sup>5</sup>

Chapter four is about trust parties and is divided into three sections. Section one (from article 19 to article 23) defines the capacity of settlor/testator and his/her rights after the creation of a trust. The settlor has, in addition to those rights which he/she has reserved in the trust instrument, a wide range of rights, such as the right to inspect, note down or copy trust accounts of trust property and other documents relevant to the conduct of the trust affairs; the right to know the revenue and the expenditure, the management, disposal of the trust property, and the right to demand the explanation of the trustee as to the conduct of the trust affairs.<sup>6</sup> He/she even has the right to require the trustee to adjust the methods of managing the trust property; the right to apply to the court to nullify the actions of the trustee; the right to demand of the trustee indemnification for losses or restitution of trust property if the trustee has inflicted losses upon the trust property through mismanagement, or disposal of the trust property in violation of the duty of a trustee;<sup>7</sup> or the right to apply the court to dismiss the trustee if the

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4 Ibid article 15, 16.

5 Ibid article 18.

6 Ibid article 20.

7 Ibid article 21, 22.

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trustee disposes of trust property in violation of the purpose of the trust, or manages or disposes of the trust property with gross negligence.<sup>8</sup>

Section two (from article 24 to article 42) contains provisions on the trustee. It provides for the capacity to be a trustee, the rights and duties of a trustee and the liabilities of the trustee for breaches of his/her duties. This section also provides for the means and methods by which the co-trustees perform their duties.

Section three (from article 43 to article 49) stipulates the range of beneficiary, the beneficial right of beneficiary, the co-beneficiaries and their rights. A beneficiary has the same rights as those of a settlor provided from article 20 to article 23. Apart from these rights, a beneficiary has also the right to disclaim or transfer his beneficial right (beneficial interests) and perform his debts with beneficial right.<sup>9</sup>

Chapter five deals with the variation and termination of trusts and it has 9 articles (from article 50 to article 58). It provides for the conditions under which the settlor or his/her heir revoke the trust and the conditions under which the settlor vary the beneficiaries or the beneficial rights of beneficiaries. It also provides for the conditions for terminating a trust and the result of the termination. Article 53 provides that:

A trust shall be terminated under any of the following circumstances: the causes of termination provided in the trust document have occurred; the continued existence of the trust will violate the purpose of the trust; the aim of the trust has been achieved or has become impossible to be achieved; the parties to the trust agree to terminate the trust; the trust has been revoked; and the trust has been rescinded.

Chapter six, which deals with charitable trusts, has 15 articles (from article 59 to article 73). It specifies for the categories of charitable purposes as follows: the relief of poverty; the assistance to victims of natural calamities; the assistance to the disabled; the advancement of education, science and technology, culture, arts and sports; advancement of medical and hygienic business; advancement of environmental protection to maintain or protect ecological environment; the advance of other public interests.<sup>10</sup> Article 62 of this chapter stringently provides that a charitable trust cannot be created without the approval of the charitable trust administrative office. To intensify the supervision and administration of charitable trusts, this chapter provides for the appointment of a trust curator.<sup>11</sup> This chapter also provides for the cy-pres doctrine. Article 69 provides that:

upon the termination of charitable trust, if there are no vested persons of the trust property or such vested persons are public who are not specific, with the

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8 Ibid article 23.

9 Ibid article 46, 47, and 48.

10 Ibid article 60.

11 Ibid article 64, 65.

approval of the administrative office of trust business, the trustee shall use the trust property for a purpose, which is similar to the purpose of the original charitable trust, or transfer the trust property to another charitable organization or other charitable trust, which has the similar purpose to the original charitable trust.

Chapter Seven has only one article, which stipulates that the Chinese Law of Trusts would come into operation as from October 1<sup>st</sup>, 2001.

## **A Compromise between Two Legal Systems**

The most important consideration for a civil law country in transplanting and accepting the law of trusts is to determine how far that law should go. It has to take account of both the essential elements of the law of trusts and its practical legal situation in order to avoid conflict between the law of trusts and the existing laws and regulations. Taking the way of compromise is the usual method for a civil law country in making of the law of trusts. From the following comparative study on some aspects of the Chinese Law of Trusts and the law of trusts in common law countries, some compromises between these two legal systems can be more easily understood.

### **The definition of trust**

Generally, it is difficult to define a trust. Although there is a definition for trust in almost every book,<sup>12</sup> they are just descriptions rather than definitions. However, 'an understanding of an area of law usually begins with a definition'.<sup>13</sup> Every Chinese law has a definition of what it regulates, and there is no exception in the law of trusts. In the context of this article, a definition of trust is introduced in article 2 of the Chinese Law of Trusts. The definition or concept of trust in China, which has been accepted from Japan and Taiwan,<sup>14</sup> is different from those in the common law countries in that the Chinese Law of Trust only stipulates three trusts: the express trust *inter vivos*, the testamentary trust and the charitable trust. In the end of article 2 of Chinese Law of Trusts, there are these words: '...for

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12 'A trust is a relationship recognized by equity which arises where 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.' Jill E Martin, *Modern Equity* (15<sup>th</sup> ed, 1997) 45.

'A trust is an equitable obligation, binding a person (who is called a trustee) to deal with property over which he has control (which is called the trust property) either for the benefit of persons (who are called the beneficiaries or *cestuis que trust*) of whom he may himself be one, and any one of whom may enforce the obligation, or for a charitable purpose, which may be enforced at the instance of the Attorney-General, or for some other purpose permitted by law though unenforceable.' Philip H Pettit, *Equity and the Law of Trusts*, (6<sup>th</sup> ed, 1977) 22.

13 Don Chalmers, *Introduction to Trusts* (1988) 1.

14 Article 1 of *Japanese Law of Trusts* and Article 1 of *Law of Trusts in Taiwan*.

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other specific purpose or purposes,' which are the same as that in the definition of trust in the Law of Trusts in Taiwan. It is not certain whether they only indicate charitable purpose/purposes or indicate both charitable purpose/purposes and non-charitable purpose/purpose. This question will have to be interpreted after a period of the operation of the Chinese Law of Trusts.

### **The classifications of trusts**

In common law countries, trusts are traditionally classified as express trusts, resulting trusts and constructive trusts according to whether the trust is created by the intention of the settlor/testator. However, the Chinese law of trusts classifies trusts as civil trusts, business trusts and charitable trusts. The result of this classification in effect denies not only the traditional common law classification of trusts, but also rules out constructive trusts and the declarations of trust. In relation to resulting trusts, this law does not recognize it in principle, but there are two provisions in article 46 and article 54 of Chinese Law of Trusts which may be construed as a recognition of resulting trusts. Article 54 provides that if there is no beneficiary or his/her heir after the trust has been terminated, the trust property shall vest in the settlor or his/her heir. Article 46 provides that a beneficiary or beneficiaries may disclaim his or their beneficial rights. Where some of the beneficiaries disclaim their beneficial rights, these disclaimed rights shall be distributed to the persons in the following order: the person who specified in the trust document; other beneficiaries; the settlor or his/her heir. So in a case where neither one of the first two kinds of persons are in existence, the settlor or his/her heir has the beneficial rights and the trust property shall vest in him/her.<sup>15</sup> It is necessary to mention here that Article 46 does not specify the person entitled to the disclaimed beneficial rights if all the beneficiaries disclaim their beneficial interests. It only provides that the trust shall be terminated if all the beneficiaries disclaim their beneficial rights.

### **The requirements of the creation of an express trust**

In common law countries, a valid express trust generally must satisfy the following requirements: the settlor and the trustee must have the capacity to act; there must be the three certainties of intention, subject matter and object; there must be written forms for certain trusts. Although so many requirements are needed to create an express trust, the method of creating such a trust is as simple as the settlor forming the intention to create the trust and transferring the trust property to the trustee.

The Chinese Law of Trusts, in accordance with the creation of a contract, stipulates in its Chapter two that the creation of an express trust has two requirements: substantive and formal requirements. The substantive requirements are divided into two categories: the active requirements and the

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<sup>15</sup> Denis SK Ong, *Trusts Law in Australia* (1999) 5.

prohibitory requirements. The active requirements, such as the settlor and the trustee must have capacity,<sup>16</sup> a trust must have a lawful purpose,<sup>17</sup> have certainty of objects<sup>18</sup> and have certainty of subject matter that must be owned lawfully by the settlor, are the same as that of common law countries. The prohibitions are as follows: the trust must not violate laws and administrative rules,<sup>19</sup> must not be created for the purpose of litigation or demanding the payment of debts<sup>20</sup> and cannot prejudice the interest of settlor's creditors.<sup>21</sup>

In common law countries, the formal requirements for the creation of an express trust may be oral requirements or writing requirements. Oral requirements are not only convenient for trust parties to create a trust, but they also apply to testamentary trusts created by an oral will.

The Chinese Law of Trusts, fashioned to meet the practical situation of China, provides for a much more stringent requirement. It requires all trusts to be created in writing.<sup>22</sup> The written documents are the contract, the will and other forms provided by the other laws and administrative rules. Furthermore, these written documents are required to state in terms the purpose of the trust, the names and addresses of the settlor/testator and the trustee, the beneficiary or the range of beneficiaries, the type and range of the trust property, the methods and forms of the beneficiary to obtain the trust interest. In addition, the written documents may, not must, state the duration of the trust, the means of managing the trust property, the remuneration of the trustee, the ways of selecting a new trustee and the reasons for terminating a trust.<sup>23</sup>

The written formalities required by the Chinese Law of Trusts for creating a trust may be instructive, in some sense, to Chinese people who have only known so little about trusts, but they restrict the creation of trusts in another sense. They not only exclude constructive trusts, resulting trusts and declaration of trusts, but they also violate the belief that a trust is created on the basis of trusting a trustee.

### **The trust contract**

In common law countries, trust is different from contract. A trust can be created by contract,<sup>24</sup> but is governed by the law of contracts.<sup>25</sup>

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16 Above n 1, article 19, 24.

17 Ibid article 6.

18 Ibid article 9, 11.

19 Ibid article 11.

20 Ibid article 11.

21 Ibid article 12.

22 Ibid article 8.

23 Ibid article 9.

24 Above n 12, 113.

25 George G Bogert and George T Bogert, *Handbook of the Law of Trusts*, (5<sup>th</sup> ed, 1973) section 24.

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An agreement to create a trust is not a trust but a contract. It is accordingly subject to the principles applicable generally to all contracts and will be enforceable only if it can be shown to be a valid and enforceable contract.<sup>26</sup>

In the light of article 8 of the Chinese Law of Trusts, a contract in writing is the formality of creating an express trust *inter vivos*. Although this article provides also that an express trust *inter vivos* may be created by other written documents stipulated by laws and administrative rules, this is only a supplementary and exceptional provision.

To stipulate that contract is the basis of creating an express trust *inter vivos* in fact combines the two different legal concepts into one, which we can call it as *trust contract*. It will bring about inexplicably complicated results for the creation of a trust, because it has two legal relationships: the contractual relationship, in which the contract parties are settlor and trustee; and the trust relationship, in which the trust parties are settlor, trustee and beneficiary.

The first issue is whether the trust contract shall be governed by the law of trusts or by the law of contracts. It is suggested that, according to the principle that a special law should prevail in case of conflict with a general law, trust contracts shall be governed by the law of trusts first, then by the law of contracts if there is no related provisions in the law of trusts, because the law of trusts is special law and the law of contracts is general law.<sup>27</sup> This explanation is not convincing. Firstly, it is arguable whether a trust contract shall be regarded as a trust or as a contract. Secondly, the segregation of the law of trusts as a special law, from the law of contract as a general law, is itself questionable.

The second result is that in the case of the replacement of a trustee, a logical error will unavoidably occur. Where a trustee, being a fiduciary, is replaced because of various reasons, the contract between him/her and the settlor will be terminated and superseded by the contract between the new trustee and the settlor in the light of the law of contracts. However, according to the principle of the law of trusts that a trust will not fail for want of a trustee, the trust can still exist without any alteration though the contract, by which the trust has been created, has changed. From the logical point of view, it is wrong in that the foundation has changed, but the building built on it has not changed.

Furthermore, in common law countries, an express trust *inter vivos* is completely constituted as soon as the settlor transfers the trust property to the trustee, and the beneficiary can enforce it as from then. If there is no transfer, there is no creation of trust. That equity does not assist a volunteer is a maxim. However, the

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26 RP Meagher and WMC Gummow, *Jacobs' Law of Trusts in Australia* (6<sup>th</sup> ed, 1997) 110.

27 Shi Tian Tao and Yu Wei Ran, *The Law of Trusts*, (1999) 67.

Chinese Law of Trusts provides that if a trust is created in the form of contract, it is completely constituted when the settlor and the trustee sign their name or seal in the trust contract,<sup>28</sup> even if there is no transfer of the trust property. Here two problems arise if the settlor does not transfer the trust property to the trustee. The trustee can only sue the settlor for breach of the trust contract, but the beneficiary cannot enforce the trust. In this case the trust, which is nominally completely constituted, is of no significance.

Again, this provision is contradictory to chapter 11 of the Chinese Law of Contract that provides for the gift contract. In the light of this chapter of the law of contract, a gift contract is completely constituted after the transfer of the gift property and a donor may revoke the gift at any time before he/she has transferred the property. A donee cannot enforce the gift conferred by the contract if the donor does not transfer the property, unless the gift contract is created for the purpose of charity or for performing moral duty.<sup>29</sup>

The problems brought about by treating the contract as the basis of the creation of a trust have to be solved as soon as possible, or the functions of the Chinese Law of Trusts will be restricted fundamentally.

### **The nature of beneficial right**

In common law countries, because of the existence of Equity, the title of trust property is divided into legal title and equitable title.

In *Hardoon v Belilios* Lord Lindley said: '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 (the trustee) and the equitable title in the defendant (the beneficiary).'<sup>30</sup>

However this division is not absolute, and there is an exception to it. Where there is a sub-trust,<sup>31</sup> namely the title vested in the trustee is itself a beneficial interest, this division is not applicable. Therefore, it is much more pertinent to divide the title of the trust property into nominal ownership and beneficial ownership.<sup>32</sup>

Whether the nature of the beneficial interest is a right in rem or a right in personam is a question which has been argued for many years, and it is still unsettled. It seems that it is not necessary to argue it again, because it is of no use in practice.<sup>33</sup> This argument is also avoided by describing the beneficial interest as sui generis.<sup>34</sup>

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28 Above n 1, article 8.

29 *The Law of Contract of the People's Republic of China* (1999) article 185, 186, and 188.

30 [1901] AC 118.

31 Above n 15, 4.

32 PV Baker and P StJ Langan, *Snell's Equity*, (29<sup>th</sup> ed, 1990) 90.

33 Above n 27, 59.

34 Above n 12, 19.

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China is a country regulated by the Civil Law System. There is no body of equitable principles in China. The Chinese property law (law of rights to things) insists on the principle of one right to one thing, namely there cannot be two different forms of ownership over one thing. There is no dichotomy of ownership in the Chinese legal system.

According to article 2, article 43 and article 44 of the Chinese Law of Trusts, the right of the beneficiary is defined as a *beneficial right* (substantial ownership); the right of the trustee is defined as a *right to property* (nominal ownership). To avoid the confusion of the two kinds of different ownership, the legal term of ownership is not adopted in the Law of Trusts in China.

In the course of drafting the Chinese law of trusts, the nature of the beneficial right was discussed. Most of the drafters thought that it could not be regarded simply as the right in rem or the right in personam since it had the nature of both of the right in rem and the right in personam. It is also suggested as an independent new type of right, just as shareholder's right created by law of company, created by law of trusts.<sup>35</sup> China is now organizing experts to draft Chinese property law (law of rights to property). The nature of the beneficial right may be defined in this law.

### **The legal status of the settlor**

In common law countries, the settlor, after the creation of a trust, has nothing to do with it if he does not reserve any rights for himself in the trust instrument, such as the replacement of the trustee or the revocation of the trust. Therefore, the core of a trust is the trustee and the beneficiary, and the settlor is hardly a party to the trust though he/she is a party to the creation of the trust.<sup>36</sup>

In contrast, the Chinese Law of Trusts grants the settlor more rights than the beneficiary, including the right to alter or dispose of the beneficiary's beneficial interest. The reason is that because an express trust inter vivos is created by contract, the settlor is a party to the trust as well as a party to the trust contract, but the beneficiary is only a party to the trust and not a party to the trust contract. Again, the Chinese Law of Trusts lays particular emphasis on the intention of the settlor, without which the trust cannot be created.

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35 Zhou Xiao Ming, *A Comparative Study on Law of Trusts* (1996) 36.

36 Above n 12, 621.

### **Variation and termination of trusts**

In common law countries, once a trust has been created, the trustee cannot vary the terms of the trust, unless it is otherwise provided in the trust instrument or by statute. But the trustee, as well as the beneficiary, has the right to apply court to vary or revoke the terms of the trust.<sup>37</sup> In addition, in the United States, the settlor can vary the trust if he/she is the sole beneficiary, even though he/she reserved no power to do so.<sup>38</sup> Also, the application of the principle of cy-pres in charitable trusts is a kind of variation of trust.

The variation of trusts provided in the Chinese Law of Trusts is divided into the variation of the management methods of the trustee, the variation of the beneficiaries or of the beneficial rights, the replacement of the trustee and the variation of the terms of charitable trusts. According to articles 21, article 23 and article 49 of the Chinese Law of Trusts, the settlor and the beneficiary have the right to demand that the trustee changes his/her methods of managing the trust property if these methods have become inappropriate for the purpose of the trust or for the beneficiary, by reason of special circumstances that could not be foreseen at the time of creation of the trust; they also have the right to dismiss the trustee in the light of trust documents or to 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 property with gross negligence.

In addition, article 51 provides that a settlor has the right to vary the beneficiaries or the beneficial rights in the following circumstances: where a beneficiary has committed a gross tort to the settlor; where the beneficiary has committed a gross tort to other beneficiaries; where a variation is agreed by the beneficiary; or it is otherwise provided by the trust instrument.

Furthermore, as far as a charitable trust is concerned, the administrative office of charitable business has the right to vary the terms of the charitable trust in the light of the trust purpose, if special circumstances, which could not be foreseen at the time of the creation of the charitable trust, have occurred after the charitable trust was created.

Apart from the above variations, article 25 of the Chinese Law of Trusts theoretically implies the right of a trustee to vary the terms of the trust if the terms have become the impediment to the efficient management on the trust, because it provides that a trustee, in administering the trust property, has the duty of loyalty, honesty, fidelity, scrupulousness and efficiency. The question whether a trustee himself/herself can vary the terms of a trust or he/she can only apply to court to alter it will have to be solved by judicial pronouncements in the future.

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37 Above n 15, 251. Above n 12, 622.

38 Above n 25, section 145.

## THE CHINESE LAW OF TRUSTS - A COMPROMISE BETWEEN TWO LEGAL SYSTEMS

In relation to the termination of a trust, in common law countries, a sole beneficiary can terminate a trust if he/she is *sui juris*. If there is more than one beneficiary, the beneficiaries can also terminate the trust as long as all of them are *sui juris* and agree to put an end to it.<sup>39</sup>

The Chinese Law of Trusts has different provisions for the termination of a trust. Article 50 provides that: 'A settlor or his/her heir can rescind the trust if he/she is the sole beneficiary. Where it is otherwise provided by the trust document, such provisions shall prevail.'

Again, according to article 46 of this Law, a trust shall be terminated if all the beneficiaries disclaim their beneficial rights. Beneficiaries cannot terminate a trust in the light of the above provisions though all of them are *sui juris*, because a trust is created by contract and the beneficiaries are not parties to the contract. In addition, a settlor can terminate a trust, in the light of article 51, if the beneficiary has done gross wrong to the settlor or the termination has been agreed by the beneficiary.

### **The Charitable trust**

The categories of charitable trusts are the same in the common law countries. They are divided into as follows: the relief of poverty; the advancement of education; the advancement of religion and other purposes beneficial to the community. Because China is a socialist country, a trust for the advancement of religion is not regarded as a charitable trust though the Chinese Constitution provides for the freedom of religion. In the light of Chinese practical situation, the Chinese Law of Trusts provides that the following trusts, such as the relief of the disabled and the victims of natural calamities, the advancement of medical and hygienic business and the maintenance and protection of ecological environment, are also charitable trusts.<sup>40</sup>

In Australia and England, where there is a breach of charitable trust, the Attorney-General represents the objects of the charitable trust and can sue the trustee in court.<sup>41</sup> In China, the trust curator plays the role of the Attorney-General in those countries. Article 64 of the Chinese Law of Trust provides that: 'A trust curator shall be appointed for a charitable trust'. The curator can be appointed by the trust document or by the administrative office of charitable business if there is no appointment in the trust document.<sup>42</sup>

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39 Above n 26, 695.

40 *The Law of Trusts in People's Republic of China*, (2001) article 60.

41 Above n 26, section 1067.

42 Above n 1, article 64, 65.

It is necessary to mention that the Chinese Law of Contract and the Chinese Law of Donation to Charitable Businesses. On March 15<sup>th</sup> 1999, China enacted its Law of Contract which came into force on October 1<sup>st</sup>, 1999. Article 188 of the Law of Contract provides that after the creation of a gift contract for relief of poverty or relief of victims of natural calamities, the donee can demand the donator to transfer the gift property if he/she does not deliver it. Considering the development of Chinese charitable business, before the Law of Contract came into force, in June of same year, China enacted the Law of Donation to Charitable Businesses and it came into operation on September 1<sup>st</sup>, 1999. This law, with 29 articles, has six chapters as follows: General provision; Donation and the acceptance of donation; Preferential measures; Legal liabilities; Supplementary provisions. The concept of charitable businesses in this law is almost the same as that of the Chinese Law of Trusts. The trustee is a charitable social organization or charitable non-profit institution. The donation is created by contract, so the trustee can sue the donor if he/she does not transfer the donated property after agreeing to make the donation. The Chinese Law of Donation to Charitable Businesses does not provide for the donation by will.<sup>43</sup>

Although some concepts of the Chinese Law of Donation to Charitable Businesses have been adopted by the Chinese Law of Trusts, both the Chinese Law of Donation to Charitable Businesses and the Chinese Law of Trusts are applicable for the time being. However, the conflicts between the two laws will be unavoidable in judicial practice. Therefore, how to reconcile the two laws will be a hard work to do in the future.

The enactment of the Chinese Law of Trusts has great significance in Chinese legal history and is a milestone in the development of Chinese legal system. Although it is not flawless, it has, after all, been legislated to cater for the practical realities in China and will enrich the Chinese legal system. It will also play an important role in improving the development of the Chinese economy.

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43 *The Law of Donation to Charitable Business of the People's Republic of China* (1999) article 12.