PART I

Overview

1

Introduction

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Background

The trust is one of the most popular legal institutions for wealth management in common law jurisdictions. In recent years, there has been a significant burgeoning of interest in the reception of the trust in civil law jurisdictions, which has fuelled enthusiasm in the comparative study of trusts around the world.[1] Several reasons account for this development, but two of them are more prominent. In the first place, the trust has been seen as a useful and flexible tool for asset management. There was thus a desire amongst some civil law jurisdictions to use the trust to enhance their financial infrastructure.[2] Secondly, the trust has been increasingly seized upon by wealthy individuals who own assets in multiple jurisdictions for holding family wealth and making succession plans in a tax-efficient way. Settlors whose domicile is in civilian jurisdictions that practise forced heirship rules have also been drawn by the perceived advantage of offshore trusts to oust these rules. Even if a civil law jurisdiction does not intend to transplant the trust, its legal system will still need to devise rules to determine whether and how to recognise it.

While the transplantation and recognition of this uniquely common law institution into a civil law setting is a fascinating subject, it has also perplexed lawyers in both worlds.[3] Civil law jurisdictions in Europe have

[1] See e.g., Maurizio Lupoi, *Trusts: A Comparative Study* (Cambridge: Cambridge University Press, 2000); Alon Kaplan (ed.), *Trusts in Prime Jurisdictions* (3rd edn, London: Globe Law and Business, 2010); Charles Gothard (ed.), *The World Trust Survey* (Oxford: Oxford University Press, 2010); David Hayton, *The International Trust* (3rd edn, Bristol: Jordans, 2011).

[2] Sarah Worthington, 'The commercial utility of the trust vehicle' in David Hayton (ed.) *Extending the Boundaries of Trusts and Similar Ring-fenced Funds* (The Hague/New York: Kluwer Law International, 2002).

[3] Some of the difficulties have been explored in, for example, Vera Bolgar, 'Why no trusts in the civil law?' (1953) 2 *American Journal of Comparative Law* 204; Tony Honoré, 'On fitting trusts into civil law jurisdictions', available at users.ox.ac.uk/~alls0079/chinatrusts2.PDF

begun to look more closely at these issues in the 1980s, culminating in the conclusion of the Hague Convention on the Law Applicable to Trusts and on their Recognition in 1985.[4] The Hague Trusts Convention enables individual states to recognise overseas trusts by laying down a framework for the resolution of conflicts of laws between common law and civil law jurisdictions. Subsequently, the Principles of European Trust Law 1999 set forth the core principles for domestic trusts.[5] Most recently in 2009, following the Action Plan of the European Commission in 2003 to devise a Common Frame of Reference to harmonise European Private Law, Book X, entitled 'Trusts', of the Draft Common Frame of Reference was published. It contains detailed provisions about all aspects of the trust, which can function as an optional instrument for adoption by potential settlors.[6] These European efforts have shown that the trust is not an exclusive institution for common law jurisdictions. Rather, it can be understood in civilian terms, and the legal structure of the trust can be replicated, albeit with appropriate modifications in civil law jurisdictions, which know no distinction between common law and equity.[7]

In Asia, Japan pioneered the reception of the trust in as early as 1922. The Japanese Trust Act was adopted as part of South Korean law during the Japanese occupation from 1910–1945, and thereafter by a separate Korean Trust Act in the 1960s. Interest in the trust, however, has lain

(last accessed 15 August 2012); Tony Honoré, 'Obstacles to the deception of trust law? The examples of South Africa and Scotland' in Alfredo Mordechai Rabello, (ed.), *Aequitas and Equity* (Jerusalem: Hebrew University of Jerusalem, 1997); James Koessler, *Is There Room for the Trust in a Civil Law System? The French and Italian Perspectives* (1 March 2012), available at http://ssrn.com/abstract=2132074.

[4] See generally, Jonathan Harris, *The Hague Trusts Convention: Scope, Application and Preliminary Issues* (Oxford: Hart Publishing, 2002).

[5] D.J. Hayton, S.C.J.J. Kortmann and H.L.E. Verhagen (eds.), *Principles of European Trust Law* (The Hague: Deventer, 1999).

[6] Christian von Bar and Eric Clive (eds.) *Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference (DCFR)* (Oxford: OUP/Sellier, 2010). For commentaries on this project, see Alexandra Braun, 'Trusts in the draft Common Frame of Reference: the "best solution" for Europe?' (2011) 70 *Cambridge Law Journal* 321; Stephen Swann, 'Book X (Trusts) of the DCFR' (2011) *Edinburgh Law Review* 462; Kenneth Reid, 'Constitution of trust: a Scottish perspective' (2011) *Edinburgh Law Review* 467; Ben McFarlane, 'An English perspective: two cheers for Book X' (2011) *Edinburgh Law Review* 467; Alexandra Braun, 'An Italian perspective' (2011) *Edinburgh Law Review* 475; Serf van Erp, 'A Dutch perspective' (2011) *Edinburgh Law Review* 479. Note also the proposed Directive of the European Union on Protected Funds: S.C.J.J. Kortmann *et al.*, *Towards an EU Directive on Protected Funds* (Devanter: Kluwer, 2009).

[7] Cf. George Gretton, 'Trusts without equity' (2000) 49 *International and Comparative Law Quarterly* 599.

dormant until the past decade or so, probably due to the enactment of the trust laws in Taiwan in 1996 and China[8] in 2001, as well as reforms of the trust laws in Japan and South Korea in 2006 and 2011, respectively.[9] These jurisdictions see the practical advantages of the trust in facilitating the development of financial products that suit the fast-changing pace of the modern investment market. The recent spate of reforms in Japan and South Korea, in particular, saw the adoption of features traditionally absent in the trust concept.

These developments have rekindled discussion of long-standing theoretical issues, such as the nature and essential elements of the trust relationship,[10] the necessity and desirability of granting legal ownership to the trustee, the utility of the concept of patrimony to the trust,[11] and the nature of the beneficiaries' rights vis-à-vis personal creditors and transferees of the trustee.[12] Resolution of these issues is particularly important for civil law jurisdictions to overcome perceived difficulties in transplanting the trust, such as the principle of indivisibility of ownership and the *numerus clausus* principle that restricts the creation of new property rights. In addition, civil law jurisdictions in Asia tend to apply the trust in a variety of complex commercial and financial instruments regardless of the lack of support in domestic legal infrastructure, and may consequently put strain on the trust and other related laws.

In light of these general questions about the nature of the trust, as well as specific issues arising from the reception of the trust in Asian civil law jurisdictions, the present book aims to achieve three goals, which will be dealt with in Part I, Part II and the Conclusion of this book:

(1) Part I provides an overview of the background and reception of the trust in Asia, and identifies the major and distinctive features of trust laws in civil law jurisdictions in East Asia which bear great

[8] For the purpose of this book, China or the People's Republic of China (PRC) is used to mean mainland China excluding Hong Kong and Taiwan (and Macau).

[9] For details, see Chapters 3 and 4.

[10] See e.g., Tony Honore, 'Trusts: the inessentials' in Joshua Getzler, (ed.), *Rationalizing Property, Equity and Trusts: Essays in Honour of Edward Burn* (Oxford: Oxford University Press, 2003); Lupoi, *Trusts* (note 1 above), pp. 223–35.

[11] Pierre Lepaulle, *Traité théorique et practique des trusts en droit interne, endroit fiscale international* (Paris: Rousseau et Cie, 1932); Kenneth Reid, 'Patrimony not equity: the trust in Scotland' (2000) 8 *European Review of Private Law* 427; Lionel Smith, 'Trust and patrimony' (2009) 28 *Estates, Trusts and Pensions Journal* 332.

[12] D.M. Waters, 'The nature of the trust beneficiary's interest' (1967) 45 *Canadian Bar Review* 217; A.W. Scott, 'The nature of the rights of the "cestui que trust"' (1917) 17 *Columbia Law Review* 269.

resemblance in terms of socio-economic conditions to one another (namely, Japan, South Korea, Taiwan and China).

(2) Part II seeks to compare, by way of hypothetical scenarios, the trust laws and operational experiences of the civil law jurisdictions in Asia to those in common law jurisdictions (in particular Hong Kong).

(3) The Conclusion draws upon the unique features of Asian civil trust laws and considers how they reflect the Asian attempt to accommodate the trust within indigenous legal doctrines in civil law. It will conclude by examining whether a set of 'Asian' principles of trust law can be discerned, and how far, if at all, they can provide a useful reference for European jurisdictions considering the adoption of the trust.

Structure and methodology

Part I

Chapter 2 outlines the reception of the trust in Asia, and highlights recent trends in the development of trust law in this region with a view to identifying both the theoretical issues it faces in transplanting the trust, on the one hand, and the practical issues arising from the predominantly commercial application of the trust, on the other. This general overview will be substantiated by four chapters (Chapters 3–6), each of which deals with a civil law trust jurisdiction in Asia. The jurisdiction-specific chapters will provide focused analysis on the historical developments of the trust, major and unique features of the trust law, and latest reforms in each of the jurisdictions under survey. These jurisdictions are Japan, South Korea, Taiwan and China, and they are considered in the chronological order in which the trust was first received. These four civil law jurisdictions are chosen for study in the book primarily because they are all civil law jurisdictions in East Asia that have enacted trust statutes, and they also resemble each other in terms of cultural background and socio-economic conditions. Needless to say, practical constraints on resources do not permit encompassing all civil law jurisdictions in Asia.

Part II

Part II is an empirical baseline study that provides cross-jurisdictional comparison on a common set of specific legal issues. It posits a set of hypothetical case scenarios and examines the legal responses of each of

the Asian jurisdictions to the specific issues raised in them. This methodology will help supplement the general survey in Part I by providing a focused study of the similarities and differences of the trust laws in these jurisdictions at a more concrete and hopefully meaningful level. This approach draws inspirations from, and hence follows closely, the Trento trust project. In 1995, Professors Ugo Mattei and Mauro Bussani launched a comparative law study project based in Trent known as 'The Common Core of European Private Law'.[13] The project made use of hypothetical fact patterns to study several areas of private law. The Trento trust project was part of the common core project. It focused on commercial trusts, and studied the extent to which there are common underlying trusts principles in European legal systems.[14] The present book has chosen to adopt the Trento scenarios, and has only supplemented but not altered them by including a few additional variations of facts. In this way, not only will the present book provide a comparative study of the approaches within Asia, it will also enable comparative inquiries between these Asian and European jurisdictions on a common range of specific legal issues.

Specifically, the hypothetical scenarios in Part II examine the operational experiences of the trust pertaining to the protection of the segregated trust funds from trustee incompetence, disloyalty or insolvency in the Asian civil law jurisdictions under review. The position of Hong Kong is also briefly considered to provide a contrast with the common law position.

Six hypothetical scenarios are devised. The hypothetical scenarios are designed to bring out the similarities and differences between common law and civil law trusts and hence the doctrinal challenges in introducing the trust into civilian jurisdictions. The organisation of the hypothetical scenarios is as follows:

- Case 1 deals with the creation of a trust. Apart from illustrating the formal and substantive requirements for establishing a trust, there will be specific focus on fundamental questions as to the relationship between trust and other analogous devices in civil law, and the necessity of transfer of ownership of trust property to the trustee.

[13] For details, see www.common-core.org/ (last accessed 15 August 2012).
[14] The results were published in Michele Graziadei, Ugo Mattei and Lionel Smith, *Commercial Trusts in European Private Law* (Cambridge/New York: Cambridge University Press, 2005).

- Cases 2 and 3 deal with the duties of trustees and the remedies for breach therefor. Questions such as whether there exists a fiduciary obligation of loyalty, and the scope of remedies for a breach of trust (e.g., compensation, disgorgement, restoration alongside civil law remedies such as annulment) will be discussed.
- Cases 4 and 5 address the effect of insolvency of the trustee on the trust fund, and raise questions such as the extent to which the segregation of the trust fund can sufficiently protect the beneficiaries.
- Case 6 is concerned with personal remedies against third party transferees of funds obtained in breach of trust.

In order to keep the project within reasonable bounds, the hypothetical scenarios examine only the use of trusts (and analogous devices) in the commercial sphere. We have also omitted from the scope of the project the use of the trust as a device for the transfer of wealth within the family, devolution of property upon death and for charity purposes.[15]

There are undoubtedly challenges involved in the current methodology. Because of the language and terminological differences across the five jurisdictions under consideration, much effort is needed to avoid being lost in translation. For example, the same legal term 'rescission' or 'compensation of loss' involves significantly different rules between common law and civilian jurisdictions. Conversely, divergent legal terms and English translations that have been recognised by their indigenous jurisdictions might actually refer to the same concept. What is called the 'bare trust' in common law exists as 'nominal trust' in South Korea and 'borrowed-name trust' in Taiwan. There is also established trust terminology in Asian civil law jurisdictions, such as the 'self-benefit trust' (viz. a trust whereby the sole settlor is also the sole beneficiary of the trust), which may not have received special attention let alone designated terminology in common law jurisdictions. Notwithstanding these obstacles, the scenario-based approach to comparative study adopted in the present book has a number of advantages. First and foremost, by extracting the legal responses of the respective jurisdictions to a common set of concrete facts that raise legal issues at a specific level, one may better appreciate the similarities and differences between these jurisdictions at a more precise level. For example, the same set of facts may give rise to a trust in some jurisdictions but mandate or agency in others.

[15] The Trento trust project also omits these areas from its scope: Graziadei *et al.*, *Commercial Trusts* (n 14 above), p. 34.

There may also be different views within the civil law systems. Contrasting approaches at the fundamental level of the legal category adopted to analyse the same fact pattern shed light on how extensive the scope and operation of the trust in different jurisdictions is in practice.

Secondly, the scenario-based approach makes it easier to appreciate that even in civil law soil, the transplanted trust can perform most of the functions that a trust achieves in common law, and often in much the same way, without any harm to its civil law environment. This will help understand the essential features of a trust and the conceptual basis of the Asian civil law trust, as will be addressed in Part III.

Part III

The unique features of Asian civil law trusts and the way their laws respond to the hypothetical scenarios will likely prompt reflections about the common features of a classic English trust: are all the features commonly found in an English trust essential to the existence and sustenance of a trust? Bearing in mind the conceptual difficulties in transplanting a trust into civil law jurisdictions and the distinctive features of the Asian civil law trust as identified in previous Parts of the book, the Conclusion examines the core concept behind the trust, and seeks to set forth its essential features. It will argue that Asian civil law trusts do meet the essential requirements of a trust, and that the omission of some common elements of the English trust, as well as the inclusion of elements traditionally not associated with it, have not done any injustice to the integrity of the trust concept. In the final analysis, it is hoped that the depth and variety of legal perspectives presented in the reports will enhance the understanding of the trust concept and its practical operation, and with it the development of a widely if not universally acceptable template for devising a coherent trust concept that can also accommodate permutations necessary for the context in which it is applied.

2

Reception of the trust in Asia: an historical perspective

LUSINA HO AND REBECCA LEE

Introduction

The aim of the present chapter is to provide an historical overview of the reception and development of the trust institution in the four Asian civil law jurisdictions under review, namely Japan, South Korea, Taiwan and China. An understanding of the motives and socio-economic background behind the reception of the trust in these jurisdictions will help understanding of the black-letter provisions of existing statutes. Equally, an appreciation of the future needs of these societies will help set directions to shape the development of the trust to meet these needs.

The trust is a flexible and popular mechanism used widely in common law jurisdictions to manage property relations, commercial transactions and community affairs. It also divides English law from continental European systems in the legal form typically used by their inhabitants for tax planning, asset management, passing wealth to future generations and keeping it within the family, managing charitable giving, structuring collective investment schemes, and providing insolvency protection in commercial transactions, to name but a few.

Ironically, partly as the result of imperialism two centuries ago, the same divide is replicated in present day East Asia. Depending on the accidents of history, the legal systems in these jurisdictions follow those of either their former imperial rulers or the country that held the most sway over their legal-political enlightenment. For example, on one side of the divide falls Hong Kong, Singapore and Malaysia, which have inherited the common law system – and through it the trust – from their former British sovereign. On the other side one finds Japan, Taiwan, South Korea and China, all of which adopt the civil law system, albeit as the result of varying, but connected, histories.

Amongst East Asian jurisdictions, Japan was the first to adopt its own Civil Code. The Meiji Restoration of 1868 catapulted Japan from