SUBSTANCE WITHOUT FORM

WHY SHAPELESS TRUSTS, AS SEEN IN ISRAEL AND NOW CHINA, COULD PLAY A VALUABLE PART IN THE INDUSTRY

BY ADAM S HOFRI-WINOGRADOW

During the first 13 years of the present century, several jurisdictions formulated and enacted new trust regimes, including the People's Republic of China's *Trust Law of 2001*.[1] The Chinese Trust Law does not specify who of the three main protagonists of the trust – settlor, trustee or beneficiary – must hold title in the trust assets, thus permitting the settlor to retain title in the trust assets without declaring himself trustee. The trust model adopted in the Chinese Trust Law can be called a 'shapeless' trust. It differs from the traditional Anglo-American trust model in a key aspect: the Chinese Trust Law does not require either the transfer of title in the trust assets from settlor to trustee or the settlor declaring himself trustee. In the decade since its enactment, the unique approach of the Chinese Trust Law has drawn the attention of numerous scholars, both in China and elsewhere. Much of the discussion has centered on the Act not requiring that the settlor transfer title in the trust assets to the trustee. In commenting on the Chinese Trust Law, scholars noted that trusts in which the trustee does not own the trust assets raise several practical and doctrinal difficulties.

This article is focused on such shapeless trust regimes that permit, among other configurations, 'settlor title retention trusts', under which title to the trust assets is left in the settlor despite the appointment of another person or body as trustee. Asking whether the difficulties attributed to the shapeless model render it inferior to the conventional Anglo-American trust model,[2] under which title in the trust assets is transferred to a trustee, the relative efficacy of 'shapeless' trust regimes will be evaluated, as well as of settlor title retention trusts. While the Chinese experience is too recent to provide substantial insights on the matter, the issues raised above may be illuminated by the annals of what seems to have been the world's first shapeless trust regime: the *Israeli Trust Act of 1979*.[3]

Shapeless trusts and settlor title retention trusts

The 'shapeless trust' moniker was coined by the great Italian trust scholar Maurizio Lupoi,[4] in response to the definition of trusts in article 2 of the *Hague Convention on the Law Applicable*

1. *Trust Law of the People's Republic of China*, 28 April 2001, Order of the President of the People's Republic of China (No. 50), with effect from 1 October 2001 (official translation at www.npc.gov.cn/englishnpc/Law/2007-12/10/content_1383444.htm), hereinafter the *Chinese Trust Law*

2. The qualifier 'Anglo-American' is used in referring to features common to the 51 trust regimes of England and Wales and the US. That is, of course, not to deny the many and significant differences between those regimes

3. Trust Act, 5739-1979, 941 *Statutes*, 3 August 1979, p128, hereinafter the 1979 Act or the Israeli Trust Act

4. Maurizio Lupoi, 'The Shapeless Trust' (1995) 1(3) *Trusts & Trustees* 15

to Trusts and on their Recognition.[5] This defined a trust as 'the legal relationships created – *inter vivos* or on death – by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose'. Lupoi described the convention's definition of a trust as 'shapeless' since it does not require that title to the trust assets vest in the trustee, unlike US, English and Commonwealth trust law. The definition of the trust in the Chinese Trust Law is no less shapeless than that in the convention. The Chinese Trust Law provides '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 a beneficiary or for any intended purposes' (emphasis added). According to Chinese scholars, the Chinese term for 'entrusts' does not amount to a requirement that the settlor transfer title in the trust assets to the trustee. This was also the view of Chinese courts that interpreted and applied the Chinese Trust Law, holding that the law does not mandate the transfer of title in the trust assets from settlor to trustee.

Similarly, the Israeli Trust Act is deliberately vague regarding several key aspects of the trust relationship, not defining either the trustee's or the beneficiary's rights in the trust property. It rests content with a definition of a trust as 'a relationship to property by which a trustee is bound to hold the same or act in respect thereof, in the interest of a beneficiary or for some other purpose'. The Israeli Trust Act contains two distinct trust regimes. One applies only to trusts created by an instrument of endowment; such trusts must be created by the settlor signing a trust instrument before a notary, by will or by beneficiary designation under an insurance policy or pension plan. The other regime applies to any fiduciary relationship involving property which the fiduciary must hold, use or 'act in respect of', applying the term 'trust', unconventionally, to this large class of fiduciary relationships. The legal provisions applicable to this second regime focus largely on the trustee's duties and powers. As regards trusts created by an instrument of endowment, the Act requires that control over the trust assets – not necessarily title – be transferred to the trustee; as regards other trusts, even this modest requirement is absent. Trustees of trusts subject to the second regime may merely 'act in respect of' trust property which they do not own, use, hold or control.

Thus, while the Chinese Trust Law is a recent example of a shapeless trust regime, it does not stand alone, as a shapeless trust regime was enacted in Israel before the Hague convention. The two trust regimes share a common feature: they permit the settlor to retain title in the trust assets, or indeed grant it to beneficiaries, despite having appointed a trustee. Further, the Chinese and Israeli definitions of a trust seem to include under the term 'trust' a large variety of relationships. For example, the definition in the Chinese Trust Law, as well as other provisions of that Law, seems to envision a trust as resembling an agency relationship. Likewise, the duties traditional Anglo-American trust law imposes on trustees are applied in Israeli law to a much wider class of fiduciaries.

Shapeless trusts – the Israeli reception

To evaluate the relative efficacy of shapeless trust regimes, it is worth briefly describing the reception of the 1979 Israeli Trust Act by courts, practitioners and academics.

Courts

Israel's courts have only fairly recently started to produce a sizable body of case law concerned with the 1979 Act. They have interpreted the Act's definition of a trust literally, acknowledging that it does not require that title in the trust

5. Concluded 1 July 1985, entered into force 1 January 1992

assets vest in the trustee. Indeed, Chinese courts have interpreted the Chinese Trust Law similarly.

Trustees, accountants and legal practitioners

The response of practitioners to the Israeli Act's innovations, including the shapelessness of its fundamental framework, has been lukewarm. Following the enactment of the Israeli Trust Act, Israeli practitioners have continued to use foreign trust regimes side by side with the domestic regime. The local trust regime is used in contexts such as nominee arrangements and trusts for disabled family members, while foreign trust regimes continue to be used for more complex family trusts, as well as where practitioners and their clients are interested in bypassing elements of Israel's fiscal or regulatory regime. It seems that Israeli practitioners' continuing practice of establishing trusts under foreign trust regimes, rather than under the domestic regime, has little to do with the shapeless character of the trust regime under the Israeli Trust Act. Leading Israeli practitioners explain that the key difficulty with domestic law is Israel's anti-perpetuity policy, which is both strict and effective, despite the absence of an explicit rule against perpetuities from the 1979 Act. Israeli practitioners do not necessarily object to the domestic trust regime permitting title to the trust assets to be elsewhere than in the trustee.

Academics

Israeli academia did not grant the 1979 Act a warm reception. Leading academics had started to criticise the Act even before its enactment. The academic criticism focused on the Act's deviating from Anglo-American trust orthodoxy, which requires that title in the trust assets be vested in the trustee. The Israeli Act's academic critics believed that the traditional Anglo-American split ownership trust model was the crux of the trust, rejecting the possibility of a looser model such as that envisaged in the 1979 Act.

The new draft Israeli Civil Code: the end of shapeless trusts in Israel?

Despite courts' and practitioners' acceptance of Israel's unique trust regime, that regime may cease to exist should the recently published draft Israeli Civil Code be enacted into law. This code, if enacted, will replace much existing legislation, including the 1979 Act. The trusts chapter of the code, drafted mainly by academics, reflects a desire to change Israeli trust law so that it better resembles traditional Anglo-American trust orthodoxy: the chapter defines a trustee as 'the owner of property, who must act regarding it for the benefit of a person or another purpose'. If the Civil Code is enacted, Israel will retreat from its shapeless trust model to a more traditional model. The draft's enactment, however, is at present highly uncertain; even if it is eventually enacted, this will happen only following several more years of parliamentary debate, which will surely result in unpredictable amendments being made to the current draft.

The future of shapeless trusts

It seems that the key lesson of Israel's experience with shapeless trusts is that such a regime is workable: Israeli courts have accepted and applied the 1979 Act's shapeless trust regime without reading the hegemonic Anglo-American trust model into the Act, as some Israeli scholars suggested that they do. It also appears that the use of foreign trust regimes by Israeli practitioners is not a product of any hostility on their part towards the shapeless trust model in the 1979 Act, but rather a result of Israel's anti-perpetuity policy. The draft Civil Code softens the perpetuities regime applicable to *inter vivos* trusts, exempting them from probate and positing a 100-year perpetuities period. This element of the draft may, if enacted, result in an increased use of the Israeli trust regime. Such an increase, if it materialises, should not be attributed to the Code's adherence to traditional common law trust orthodoxy regarding the location of title in the trust assets.

As mentioned, Israeli academics, unlike the courts and practitioner community, have for decades disapproved of the shapeless trust regime. It is evident from the protocols of the committee which drafted the Civil Code that the shapeless trust's main opponents on the committee were professors. In China, similarly, criticism of the Chinese Trust Law was mostly by academics.

Considering the (negative) state of academic opinion on shapeless trust regimes, the rest of this article is dedicated to an examination of their advantages and disadvantages.

Shapeless trusts and settlor title retention trusts: difficulties and disadvantages

As mentioned above, recent work on the Chinese Trust Law has pointed out several difficulties raised by that Act's facilitation of trusts where the settlor, despite having appointed a trustee, retains title in the trust assets.[6] In the following section I will present the (mainly) practical difficulties attributed to the Chinese Trust Law and its shapeless definition of a trust, and examine whether these difficulties suffice to conclude that shapeless trusts generally, and settlor title retention trusts specifically, are inferior to the conventional Anglo-American trust model.

The first difficulty which has been raised is that '... a trustee who derives powers indirectly, from the ownership of others, will have the tiresome burden of proving these powers to the satisfaction of third parties'.[7] This difficulty is not unique to the shapeless trusts or settlor title retention trusts: it also applies, for example, to trust regimes under which the beneficiaries own the assets, such as the South African bewind trust. Moreover, shouldering the burden of obtaining a power of attorney should not be impossible, given that US law, for example, provides by statute both rules protecting persons who in good faith accept and rely upon acknowledged powers of attorney, and rules mandating the acceptance of such powers.

The second difficulty which has been raised is what happens to the trust assets when owner-settlors or owner-beneficiaries die or are dissolved (the Chinese Law, for example, provides a mechanism for replacing a dead or dissolved trustee, but not for replacing a dead or dissolved settlor or beneficiary), when the identity of all or some owner-beneficiaries is disputed, or when trusts of assets owned by their beneficiaries go through periods when no living, identified or identifiable beneficiaries exist. These difficulties do not appear insurmountable either. The workability of trusts where the assets are owned by the settlor or beneficiary requires

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6. Kenneth G C Reid, 'Conceptualising the Chinese Trust: Some Thoughts from Europe', in *Towards a Chinese Civil Code: Historical and Comparative Perspectives* 209-231 (Remco van Rhee and Lei Chen eds, 2012). Also available at papers.ssrn.com/sol3/papers.cfm?abstract_id=1763826

7. Reid in van Rhee and Chen

arrangements governing several aspects of those trusts' functioning, which can be supplied by statute, case law, or in the trust instrument. However, the workability of trusts where trustees own the assets requires no less. While rules requisite for the smooth operation of trusts on the conventional model have already been developed, the extension of the trust concept to shapeless trusts would require that new rules be supplied. For example, if owner-settlors or owner-beneficiaries passed away, ownership of the trust assets could pass according to the rules of law usually applicable to the devolution of a deceased or dissolved right holder's property, namely the law of inheritance and company liquidation. Unless otherwise provided in the trust instrument, the segregated trust fund would survive the owner-settlor or owner-beneficiary's death or dissolution: his, her or its executor, administrator, heirs or liquidator would hold the trust fund on trust for the relevant beneficiaries or purpose, trust assets being answerable to trust debts alone. Another possibility is that ownership of the trust assets could be vested in a fluctuating group of beneficiaries: much as the law provides a means for the appointment of new trustees when none remain, the law or trust instrument could similarly provide for the appointment of new owner-beneficiaries, in a manner tracking the settlor's express or implied intentions. Where the primary motivation behind the creation of a trust is avoiding probate or minimising a settlor's exposure to creditors (assuming asset-protection trusts are allowed), trustees, a beneficiary other than the settlor, or beneficiaries as a class, could serve as owner of the trust assets. Where the inexistence, for a time, of any beneficiaries, or disputes as to their identity, are possible, title in the trust assets could be granted to either the settlor, the trustee or, again, 'the beneficiaries of X trust' as a class, which could have no members for a while. It thus appears that all three points of the trust triangle can serve as owners of the trust assets, depending on the type of trust envisioned, its purposes, its lifespan and the circumstances likely to occur during its existence.

The final difficulty raised regarding the retention of title in the trust assets by their settlors is that under current Chinese law, such settlors owe no fiduciary duties, and could thus act in breach of trust, leaving the beneficiaries largely defenceless. One might argue in response that where settlors merely retain title in the trust assets, having appointed another as trustee, they could be subjected to duties sufficient to protect the trust and its assets without being granted powers to voluntarily dispose of or otherwise manage the trust assets. The very lack of such powers could provide some of the necessary protection. While where settlors or beneficiaries retain title to the trust property the trustee will need their cooperation in order to apply that property towards the trust's purpose or for the benefit of its beneficiaries, the titleholders could be contractually obliged to offer the necessary assistance, e.g. convey title in the assets as instructed by the trustee.[8]

It seems, then, that the difficulties raised concerning trusts where the settlor or beneficiaries hold title in the trust assets, without also serving as trustees, do not suffice to determine that such trust regimes are inherently inferior to trusts on the traditional model. Nor do they suffice for condemning the Chinese or the Israeli shapeless trust regimes. While the current Chinese or Israeli Acts may not be perfect and may perhaps call for some amendment, such as imposing fiduciary or other duties on settlors who retain ownership of the trust assets, the imperfections

8. An additional difficulty is that where trustees do not own the trust assets and have no means to obtain them, a non-owner beneficiary may lack a fund from which to collect redress for trustee infractions. This difficulty may be resolved in at least two ways. One is giving non-owning trustees powers to require the owner to hand over part or all of the fund. Such a power can be limited to specific circumstances, such as the award of a court judgment against the trustees related to their conduct as trustees of the trust. Another way to deal with the same difficulty is by reverting to the traditional common-law rule according to which the primary fund liable to compensate beneficiaries for trustee infractions was the trustee's non-trust property, rather than the trust fund

> Settlor title retention trusts may help introduce the trust mechanism to potential settlors unaccustomed to it

of existing shapeless trust regimes could hardly serve as arguments for rejecting the very idea of trusts where settlors or beneficiaries retain title in the trust assets. Different trust models could suit different circumstances. Property held on revocable trusts, for example, is already seen by US law as if it was still held by its settlor, at least regarding the rights of the settlor's spouse, relatives and creditors, including the tax authorities. The conceptual gap between such a presumption and a settlor's actual retention of title in the trust property does not appear significant. It may be that retention of title in the trust assets by the settlor would frustrate the purpose of trusts created to avoid probate or minimise the burden of estate or inheritance taxation. That such trust designs defeat the purpose of some trusts does not imply that they would never be useful.

Shapeless trusts and settlor title retention trusts: advantages

Shapeless trust regimes may also have some advantages over the traditional trust model. One is their making the duties the law of trusts imposes on trustees and the effective remedies it gives beneficiaries applicable to fiduciary situations involving non-owner asset managers. The application to such asset managers of the trustee's duties, such as the duties of prudence, loyalty, impartiality, full and prompt accounting and reporting, and refraining from conflicts of interest and duty, seems desirable, considering the risk of such managers succumbing to the temptation of preferring self-interest to their clients' interests. Such an application may not, however, significantly transform the duties and liabilities to which such managers are already subject, as in many jurisdictions legislation has already applied similar duties to such managers, independently of their being subjected to trustees' duties. Further, in so far as some or all of those duties may be disapplied by contract or trust deed, and are so disapplied in practice by way of exemption clauses, their extension to additional classes of asset managers is likely to be even less consequential.

A further advantage, which is perhaps of more consequence, is that settlor title retention trusts may help introduce the trust mechanism to potential settlors unaccustomed to it, who may be deterred by the prospect of giving away title in their property. Many property owners outside the traditional Anglo-Saxon sphere of trust practice would be very much deterred by such a prospect. Chinese scholars actually implied that the Chinese Trust Law's lack of a requirement that trust assets vest in the trustee might be a result of its drafters' fear of such a deterrent effect,[9] and a leading Israeli practitioner has said that potential Israeli and Jewish settlors are in fact so deterred. It has been shown that the fears and expectations of potential users can play a significant role in

9.Lusina Ho, 'Trust Laws in China: History, Ambiguity and Beneficiary's Rights', in Lionel Smith (ed) *Re-imagining the Trust: Trusts in Civil Law* (Cambridge University Press, 2012) 183-221, 201

the process in which imported legal institutions are adapted to local circumstances. Offshore jurisdictions, purportedly adhering to the traditional common-law trust model, have developed settlor-reserved powers to successfully market trust services to potential settlors fearful of or uninterested in letting go of their property. Some of these jurisdictions, while vesting title to the trust assets in the trustee, permit the settlor to retain a vast panoply of both administrative and dispositive powers, providing explicitly by statute that such reservation shall not invalidate a trust.[10] The Chinese and Israeli shapeless trust regimes, by leaving actual power to administer and dispose of trust assets in the hands of trustees, are closer, in functional terms, to the traditional trust model than to such offshore regimes. So long as adequate means are in place to ensure that settlors do not use their retained ownership to impermissibly interfere in trustees' execution of their functions, the settlor title retention trust can be seen as a relatively direct means of making trusts palatable for a wider circle of potential settlors, involving less real injury to the separation of enjoyment and control – one of the foundational ideas behind trusts – than the alternative means developed, for the same purpose, by jurisdictions offshore.

Concluding remarks

The schematic division of labour envisioned by the traditional Anglo-American trust model, with the settlor having nothing to do with the trust once constituted, the trustee serving as its exclusive manager, and beneficiaries passively enjoying their entitlements and, if necessary, turning to Chancery to enforce the trust, is now being challenged by both the real-life functioning of actual trusts and innovative trust regimes developed by various jurisdictions. Settlors can, if they wish, find ways to influence their trustees' conduct, whether or not that influence is formalised in the trust instrument, and whether or not it is in keeping with the trust's governing law or other relevant legal frameworks. Beneficiaries, similarly, sometimes try to influence trustees' decisions. Given the fundamentally facilitative nature of trust law and the increasing variety of trust regimes worldwide, many of which apply to populations unfamiliar with traditional Anglo-Saxon trust culture, it may be that there are few reasons to insist on the continuing exclusivity of the traditional trust paradigm, granting title in the trust assets to the trustees. Other models, including settlor title retention trusts, may have their uses. Though such models, contradicting the traditional common-law trust paradigm, raise practical and doctrinal challenges, it seems that the cautious, permissive Chinese and Israeli approach, shapeless though it may be, could have some potential after all.

10. E.g. the *Trusts (Jersey) Law 1984*, s9A, inserted by the *Trusts (Amendment No. 4) (Jersey) Law 2006*, which provides, *inter alia*, that the reservation by a settlor of powers to revoke, vary or amend the trust, of powers to pay trust income or capital, or of powers to give the trustee binding directions regarding management of the trust assets, 'shall not affect the validity of the trust nor delay the trust taking effect'. The *Trusts (Guernsey) Law 2007*, s15(1), improves on the Jersey model by providing that even should a settlor reserve powers of all those types, the trust shall not thereby be invalidated

ADAM S HOFRI-WINOGRADOW IS ASSOCIATE PROFESSOR, MONTESQUIEU CHAIR IN COMPARATIVE LAW AND LEGAL HISTORY, AT THE HEBREW UNIVERSITY OF JERUSALEM FACULTY OF LAW, AND VISITING PROFESSOR AT GEORGETOWN UNIVERSITY (FALL 2013). THIS ARTICLE IS BASED ON HIS ARTICLE 'SHAPELESS TRUSTS AND SETTLOR TITLE RETENTION: AN ASIAN MORALITY PLAY' (2012) 58 LOYOLA LAW REVIEW 135. THE AUTHOR THANKS ADV SARITH FELBER OF THE SUPREME COURT OF ISRAEL FOR HER WORK ON THIS ABBREVIATED VERSION