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On the Dual Attributes of Charitable Trusts in China

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Abstract: Based on the legal attribute of charitable trusts (CTs), they should be interpreted as organizations. In practice, CTs are not only a type of trust but also a charitable organization with unique dual attributes focusing on public welfare and profitability. Their core function is to achieve the goal of charity by using the trust as a tool, although they have the characteristics of a trust in terms of external representation. The dual attributes of CTs present new challenges in terms of governance mechanisms, which must be different from those of traditional charitable organizations and the general corporate governance mechanisms applied to trust companies.

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Literature Review and Brief Comments

Following the promulgation and implementation of the *Trust Law of the People's Republic of China (PRC)* in 2001, and after more than a decade of rapid development, the country's trust industry has achieved good results. However, the establishment of a related trust system in the fields of public welfare and charity has been far from satisfactory. The *Charity Law of the People's Republic of China* (hereinafter referred to as "the Charity Law"), which was promulgated and implemented in September 2016, contained a specific

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chapter on charitable trusts (CTs), in which it was stipulated that they are categorized under public welfare trusts. Statistics show that there was a total of 267 CTs registered nationwide as of December 31, 2019. The overall characteristics of the trust industry included rapid development, small capital scale, inconsistent and irregular filing and registration, unclear legal nature and status, and trust companies being the majority of the trustees. When CTs are the research subjects, their dual attributes of being a charity and a trust must form the basis, on which the relevant literature is reviewed and compiled for analysis and summary.

The Legal Nature of the Trust Property and Its Independence

The legal nature of the trust property, and its independence form the cornerstone of the trust legal system, which means that the legal nature and definition of CTs can directly affect their governance and supervision, as well as the protection of the rights and interests of their beneficiaries. In *Research on the Jurisprudence of Trust Law (2nd edition)*, He Baoyu conducted an in-depth analysis of the principles of trust law that was supplemented by a description of cases. There was also a comparative analysis of the basic concepts of trust law in Anglo-American legal systems versus Continental legal systems (these two major jurisdictions are also known as Common law system versus Civil law system), the main distinctions between the two systems, and the reasons for their respective formation, where the independence of trust properties was specifically explained (He, 2005). Zhang Chun adopted an original approach in his book *Characteristics of the Trust Law in China* by making a detailed analysis and summary of the characteristics of trust property ownership in the country. The characteristics of the law's effectiveness regarding trust registration were incorporated in the book, making it featured research highlighting the country's trust laws (Zhang, 2013).

In *Trust System: Legal Principle and Practice*, Zhou Xiaoming provided an insightful explanation of the definitions and functions of trusts through the independent nature of trust properties under Common Law (Zhou, 2012). In *Trust Law in China*, Zhao Lianhui examined and verified the basic system and theory of the trust laws with a focus on the legal nature and registration of trust properties in China, and proposed that the "non-compatibility" of the trust system should not be overemphasized (Zhao, 2015). A detailed study on the respective history of the development of national trusts and trust legislation under Common law system and Civil law system was made in *Summary Discussions of the Trust Law*, as well as comparative research on the legal nature and development direction of trust properties in China (Huo, 2003). Yu Haiyong summarized the historical evolution and modern development of Anglo-American trust law in the book *Localizing the Anglo–American Legal Concept of Dual Ownership of Trust Properties in China*, and argued that the concept of dual ownership could be successfully localized in China (Yu, 2011). In the monograph *Studies of Trust Property Rights*, Tang Yihu analyzed the legislative structure and basic contents of rights over trust properties, discussed the independent nature of trust properties and changes to their rights, and conducted a theoretical discussion on the separation of rights of trust properties (Tang, 2005).

Charitable Trusts

Since CTs are a type of charitable organization, they can be studied through specialized books and expositions on charitable and public welfare trusts. In addition, research on charitable organizations and non-profit organizations (NPOs) can provide important guidance and be of reference value. In the book *Interpretation and Application of the Charity Law of the PRC*, Zheng Gongcheng interpreted the country's newly promulgated Charity Law article by article. His theoretical analysis and practical insights provided an important reference and a basis for understanding and applying the law (Zheng, 2016). Xia Yu conducted a systematic perusal and analysis of CTs under the different backgrounds of the two major jurisdictions in *CTs from the Perspective of Comparative Law*. This detailed and comprehensive study on comparative law enabled us to further our learning and analysis of CTs (Xia, 2017). Xie Kun believed that "CTs are an organizational form of charitable organizations that first appeared in Britain" (Xie, 2011). In his article "Study on the attribution of governmental regulatory powers over CTs," Wei Yan clearly demonstrated that CTs should be regarded as legal entities and a form of organization from the perspective of governmental regulatory powers (Wei, 2018). Based on the provisions on CTs in the *Trust Law of the PRC* (hereinafter referred to as "the *Trust Law*") and the corresponding legal interpretations, Liu Yingshuang opined that, "Our public welfare trusts are a type of social organization" (Liu, 2015). Correspondingly, public welfare trusts, which are under CTs, should also be understood as "organizations" or "institutions."

Overall Review of the Relevant Literature

It is apparent from the literature review that although the Charity Law is comparatively new, and that current research on CTs in China is still at the infancy stage, considerable progress has already been made. Nevertheless, the following issues exist in the related theoretical research of CTs: (i) although there are many studies on the trust legal system, the majority of the country's literature focus on the basic trust system. Sufficient emphasis has not been placed on public welfare trusts, especially CTs; (ii) there are many studies on NPOs and charitable organizations, but few on CTs specifically. To be precise, the CT system was not officially established under the jurisdiction until September 1, 2016. Given the short time span since then, theoretical research and applications of the system have yet to become widespread. This explains the relative lack of professional research literature at present;[①] and (iii) among the existing research literature on CTs, which is limited in number, there is a lack of in-depth research and evaluations made from the perspective of their dual attributes. Currently, discourses are predominantly comparative and analytical studies on the basic CT system. The focus has been on the basic theories including their origin, establishment, and their related rights and obligations. There are still insufficient theoretical interpretations and in-depth research of the

① A search was made on HowNet (China National Knowledge Infrastructure/CNKI) for documents on the subject of CTs published from September 1, 2016 (promulgation of the Charity Law) to January 31, 2020 (date of review for this study). After newspaper reports and master's thesis were excluded, 26 academic and professional papers related to CTs published in doctoral dissertations and professional academic journals were identified, of which only three were in the core CSSCI journals of Nanjing University. (HowNet: https://www.cnki.net/, last accessed on February 2, 2020.)

organizational aspects of CTs and their dual attributes and governance mechanisms.

Theoretical Definition of the Dual Attributes of CTs

The general consensus is that the trust legal system regarding the two major jurisdictions is different in many aspects, including the registration and establishment of trusts, ownership of trust properties, and trust supervision. The same applies to CTs. Given this, China's CT system is also different from that under Common Law in terms of trust property ownership, registration, and supervision. The concept and meaning of CTs in China are stipulated in Article 44 of the Charity Law.[①] By definition, "CTs are a way of doing good deeds. They have charity as their purpose and the trust as their means. At the same time, they embody the dual significance of demonstrating charitable behaviors and being charitable organizations" (Zheng, 2016).

CTs are subjected to dual regulations under the *Charity Law* and the *Trust Law*. However, the positioning of the legal department administering the *Trust Law* is commercial law, which is inconsistent with the positioning of social law governing the Charity Law. Under China's unique traditional jurisdiction, CTs can be regarded, to a certain extent, as a special type of trust system, as well as a form of the charitable organization with special attributes. It is an innovative concept to consider their dual attributes of public welfare and profitability. Doing so indicates that CTs are a special type of charitable organization, revealing that they not only have the non-profit and public welfare characteristics of charitable organizations, but also the profitability of trusts and the natural pursuit of asset efficiency. The dual attributes clarify that the core function of CTs is to achieve the goal of charity by using the trust as their tool and means to achieve charitable goals, even though they have the characteristics of a trust in terms of their external representation.

The dual attributes of CTs are manifested in several ways. As charitable organizations, CTs should focus on public welfare and non-profitability, with the former being their most basic and essential feature. As a trust, however, profitability and the pursuit of profit maximization should be paramount. This is because a trust is one of the most effective ways to utilize property rationally while maximizing property value in the process. CTs pursue public welfare and non-profitability under their attribute as charities, and also pursue profitability and efficiency maximization under their attribute as trusts.

Although they are a form of charitable organizations, CTs differ from charitable organizations as they do not merely manage donations and charitable assets. If CTs only emphasize their non-profit or public welfare nature and limit their function to property management, their function as trusts will be weakened. If they only focus on value appreciation and profitability, their charitable and public welfare characteristics will be undermined. In a sense, CTs are a unique trust system that is dissimilar to general private trusts and business trusts. They are also a special and hybrid type of charitable

① Article 44 of the Charity Law stipulates that "for the purpose of this Law, "charitable trust" falls under public welfare trust, which means the activities under which the principal authorizes its property to the trustee in accordance with the law for charitable purposes, and the trustee manages and disposes of the property in the name of the trustee according to the principal's wishes, and conducts charitable activities."

organization that differs from traditional charitable organizations due to their dual attributes of public welfare and profitability. It is precise because of this that CTs have dual attributes in various aspects, including property ownership, nature, and supervision. To a certain extent, the dual attributes of CTs can be regarded as their most unique and essential features.

The dual attributes of CTs manifest in three dimensions and levels: One is the dual attributes of the CTs properties, another is the dual attributes of the CTs nature, and the third is the dual attributes of CTs supervision, which are going to be theoretically analysed hereinafter.

Dual Attributes of CT Properties

"The concept of dual ownership is the cornerstone of the trust system" (Underhill & Hayton, 1995). "The presence or absence of the trust concept, the core of which is dual ownership, reflects one of the most important variations between the two major jurisdictions in relation to substantive private law" (Chen, 2016).

Interpretation of the Dual Ownership Theory

As the name implies, dual ownership refers to the trust property owned by the trustee and beneficiary, and that this duality exists concurrently. This means that after the trust is established in accordance with the law, the trustee is entitled to ownership under Common Law in accordance with the relevant provisions of Common Law (also known as the legal title), whereas the beneficiary is entitled to ownership under the Equity Law in accordance with the relevant provisions of the Equity Law (also known as the equity title). The design of a system with property ownership being transferred and divided is the essence of the Anglo-American trust system. "There must be a distinction between legal and equity ownerships in a legitimate trust legal relationship: the former is vested in the trustor; the latter is entitled to the beneficiary. The distinction between Common and Equity Laws is real and natural within this scope" (Underhill, 1894).

Salmond John William, the British trust jurist, made the following statement that a trust is the most important and direct evidence of dual ownership. Trust property is concurrently owned by two parties, and their relationship is such that one party has the obligation to exercise its ownership in the interests of the other party (Salmond, 1930). He further explained that ownership of the trust property by the trustee can be termed "trust ownership," while that by the beneficiary is known as "beneficial ownership." The trustee is not entitled to any benefits that are related to the beneficiary of the trust property. In the trust legal system under Common Law, the dual ownership of trust property is certainly the only one of its kind and distinct from that under Civil Law.

The creation of dual ownership has its special background and basis, namely the dual or binary jurisdiction that was formed in the UK following the continuous development of Common and Equity Laws. In the Anglo-American legal system, the emergence and development of intangible properties and other forms of economic interests forced Common Law to recognize and protect these new forms

of interest. This resulted in many new types of property rights being confirmed under Common Law, which was in accordance with its clauses on due process and the legal precedents. In doing so, the connotations and denotations of property rights were broadened.

Dual ownership is the core concept of a trust, and it is a product of Equity Law that pays attention to only the ownership of trust property (Arthur, 1894). It is evident in trust legal relationships that the ownership of a trust property contains both control and beneficiary rights, with the two rights being separate. Based on the traditional concept of equity, the law should grant definite and reasonable ownership status to those who are entitled beneficiaries of specific properties. Although beneficial ownership in this concept is relative rather than absolute, it is the beneficiary and not the trustee who has the ultimate right to the trust property, as well as being the only party who enjoys that ultimate right. In this context, the Equity Law should provide relief and protection to a trust's beneficiary.

The Practice of the Dual Ownership Theory in China

Under Civil Law, the theory of ownership is singular and absolute, even with multipl entities, which is the exact opposite of the dual ownership theory in terms of property rights under Common Law. However, the concept of ownership of property under Civil Law is not completely absolute: the form of ownership separation has already existed since Roman law, such as the separation of ownership under Civil and Magistrate Laws (Scott, 2011). In practice, ownership under the two sets of laws is of equal status. "It is generally believed that the magistrate was one of the creators of Roman equity" (Buckland, 1911). The renowned jurist Gaius made the direct summation that the structure of ownership separation under Roman law was dual ownership. He further pointed out that "according to the provisions of Roman law, Roman citizens enjoy dual ownership either in good faith or as granted by a magistrate. Legal ownership can be either statutory or civil, and a property can be subjected to both types of ownership concurrently" (Poste, 1904).

This structure of dual ownership, which was newly emerging at that time, provided the theoretical source and evidential support for the transplantation of Civil Law (which inherited the traditions of Roman Law) and referenced the system of dual ownership under Common Law. "The greatest contribution of Roman Law to world civilization is that it showed the world that it is entirely possible to establish a legal system with common sense as the basis, and which is acceptable to different nations at various stages of development" (Lawson, 1998). Therefore, when countries and regions under Civil Law construct trust legal systems, they can similarly borrow from the system of dual ownership and stipulate a new type of property right under the Civil Code or Property Law, namely beneficial ownership. This will permit the ownership system under Civil Law to connect perfectly with the dual ownership of trusts.

"In the field of Property Law, the trust system has caused huge contradictions in the ownership legal system between Common and Civil Laws" (Bolgar, 1953). The dual ownership theory subverts the absolute ownership theory in traditional Civil Law, in which a property has "singular" ownership. "The emergence of equity ownership completely broke through the theoretical framework for

property ownership under traditional Civil Law, as if a mysterious and incomprehensible act of magic was performed in front of it" (David Johnston, 1988). Therefore, when countries and regions under Civil Law transplant the trust legal system of Common Law, they will inevitably face conflicts between dual ownership inherent in the system created under Common Law and their own property ownership theory under traditional Civil Law.

The primary problem to be considered and resolved for countries and regions under Civil Law is determining the means to realize the transplantation, referencing, and localization of the trust system, specifically the ownership system of trust properties. China's Civil Law belongs to the Continental legal system, and the trust legal system was transplanted under the theoretical framework of absolute ownership in which a property has singular ownership. This means that the concept of dual ownership and the basis for its application is lacking in China's civil law. At the same time, the *Trust Law* has not made clear the legal nature of the rights of trust beneficiaries.

For dual ownership under the Anglo-American legal system, the rights enjoyed by the trust beneficiaries regarding the trust properties are those of the nature of ownership, which is clearly equity ownership. However, due to the limitation of absolute ownership under the Continental legal system, China's legislation has adopted the strategy of avoidance when it comes to defining the beneficial rights of trusts. This has resulted in a key link being missing when localizing the *Trust Law*, namely the positioning of equity ownership. The vacuum caused by the legislative avoidance has resulted in controversies within academic circles, especially in relation to the theories on property rights, credit rights, the coexistence of property and credit rights, and special rights. The provisions in the *Trust Law* on registering trust properties have existed in name only. Despite *Trust Law* having established a higher legal position for the registration of trust properties, the relevant supporting systems and implementation policies are incomplete. There are also shortcomings in the linkage of this law to the other legal systems.

Looking at the relevant provisions, Article 10 of the *Trust Law* stipulates that an application for trust registration must be lodged with the relevant authority when a trust is established, and that an unregistered trust is deemed to be invalid.[①] However, the trust registration and its supporting systems have not been perfected, such that actual situations exist where there is uncertainty and unclarity regarding the registration authority, the scope of the registration, and the rights and responsibilities related to the registration. To illustrate, when *Measures for Building Registration* (Expired)—the basic legal system for real estate registration—was enacted, the registration of real estate trusts was not included in the statutory scope of those measures for reasons or considerations unknown.[②] In

① Article 10 of the *Trust Law* stipulates that where trust property shall be registered according to the provisions of laws or administrative regulations for the establishment of a trust, such property shall be registered. If the trust registration fails to be made as required in the previous paragraph, it shall be made up later; the trust shall be invalid if no make-up trust registration is effected.

② Article 32 of the *Measures for Housing Registration* (Expired) stipulates that the parties concerned shall apply to register the transfer of house ownership after the relevant legal documents have become effective or after the fact when any of the following circumstances occur: (i) buying and selling; (ii) mutual exchange; (iii) bestowed as a gift; (iv) inheritance or bequest; (v) division or merger of houses leading to a transfer of ownership; (vi) use of a house as a capital contribution; (vii) division or merger of judicial persons or other organizations leading to a transfer of house ownership; and (viii) other circumstances as stipulated by the laws and regulations. Although this article has a fallback clause, it is still limited by the existing ownership system. As such, it is not possible to explicitly incorporate the registration of trust properties no matter how the law is interpreted.

addition, the handling of registrations for other forms of trust properties (such as movable properties, intellectual property rights, and securities) is not clearly stipulated in the corresponding departmental laws. For trust properties, the unclear ownership and nature of beneficial rights have severely hindered the pro-activeness, operability, and standardization of trust registrations by the relevant authorities.

Countries and regions under Civil Law system may still be adhering to the principle that a property has singular ownership. However, the reforming effect of Common Law on the modern ownership system must be acknowledged to resolve the conflict between the theory of property rights under Civil Law system and the concept of trusts. When the structure of dual ownership is adopted through legislation, ownership should be functionally divided for some specific property relationships such as trust systems. Accordingly, ownership rights should be assigned to different subjects. The corresponding rights should also be guaranteed through system designs to ensure they do not conflict with one another, nor contradict the traditional singular ownership concept. The purpose of transplanting the trust legal system is to realize its essential function, rather than simply replicating the formal design of the system as practiced overseas.

"In Civil Law, ownership is the most comprehensive right of control over properties. Ownership under Equity Law has almost no content over the administration of trust properties. Its essence is merely passive prevention of misconduct by the trustee. Therefore, during the localization process, excessive attention should not be paid to the literal meaning of equity ownership. Instead, the focus should be on its institutional function" (Yu, 2010). Localizing dual ownership into the singular property and credit rights of Civil Law led to the formation of a binary structure of property and credit rights under the trust legal system of Civil Law. Consequently, there was not only integration and connection, but also the realization of substantive functions. This way, the practice of the dual ownership theory and its system could be smoothly localized for implementation in China.

Dual Attributes of CTs: Public Welfare and Profitability

Regardless of Common Laws or Civil Laws, trusts are considered in modern societies to be the most effective means of utilizing properties rationally and maximizing the utility values of those properties. The advantages of the trust system lie in its ability to efficiently enhance the value appreciation of trust properties through professional management by the trustee, as well as the pursuit to maximize trust benefits. As a special type of charitable organization, the most essential attribute of CTs is the public welfare, which also directly reflects their core value. CTs should bear the characteristics of public welfare and non-profitability, with the former being its most fundamental feature. Non-profitability and profitability are relative. Profitability refers to the aim of making profits, which involves the pursuit of profit maximization and economic returns on investments.

Incorporated companies are typical representatives of for-profit organizations. Such organizations are independent subjects of competition and interests in the market economy, and the basic principles that they adhere to are interest and competition. The pursuit of profits (that is, profit

maximization) is its business purpose and most significant goal. As stipulated in the *Measures for the Administration of Charitable Trusts*, CTs are non-profit corporations. However, the execution of a trust is a for-profit activity under Commercial Law. A more comprehensive and accurate understanding of the dual attributes of CTs can be obtained through a comparative analysis of profitability from the perspective of non-profitability: Since charities focus on public welfare and non-profitability whereas trusts pursue profitability and efficiency maximization, CTs by nature bear dual attributes as their essence.

Profitability of Trusts and Their Institutional Functions

The nature of trusts is such that a trustor possesses and manages the trust property through the trustee to achieve the purpose of the trust, so that the beneficiary can enjoy the trust benefits. The function of trusts is that although the trustor has ownership of the trust property as a formality as prescribed by law, the beneficiary's rights to the trust property is substantially the ultimate right. Through the institutional structure of trusts, there is a separation between the trustor's ownership of the trust property and the beneficiary's substantive interests and rights. This creates and provides a "property safety zone" for the beneficiary based on preserving and appreciating the value of the trust property.

A trustor legally transfers the trust property to the trustee by establishing a trust based on mutual faith and consensus, thereby granting independence to the trust property. The trustee then executes the duty of managing the trust property in accordance with the purpose or goals of the trust, while abiding by the principles of kindness, loyalty, and prudence. Generally, in a trust legal relationship, a trust can have one purpose or multiple purposes that co-exist concurrently. As far as the trustor and beneficiary are concerned, the fundamental purpose of the trust is to preserve the value of the trust property and with that as the basis, further seek a considerable degree of value appreciation. The fundamental and typical function of the trust system is to pursue and realize the preservation and appreciation of the value of the trust property. Therefore, the basic function of a trust is essentially the management of the trust property, which is a dual management function integrating the preservation and appreciation of the property's value.

The function of value preservation.

This is also known as the protection function, which refers to the purpose of establishing a trust to preserve the safety of the trustor's trust property, realize the isolation, appreciation, and inheritance of the trust property, and protect the beneficiary's trust rights and interests. With the development of modern trusts, new types of trusts have been introduced that go beyond the traditional functions of preservation and appreciation. Examples include special trusts emphasizing the protection of minors or the elderly. This type of protection-based trusts is set up for the rights and interests of a specific group of beneficiaries, specifically in relation to their lives and living maintenance. The main purpose is not to realize value appreciation of the trust property, but to preserve and maintain the stability of the trust property and prevent its reduction or loss. For example, both the American trusts for

support and British protective trusts have the main purpose of protecting the beneficiaries' living needs (Wang, 2018). In Japan, the system of special donation trusts, also known as special disability support trusts, is recognized under the country's *Inheritance Tax Law*. The purpose of such trusts is consistent with that of the American trusts for support and British protective trusts, all of which emphasize the preservation function of trusts.

The function of value appreciation.

Trusts, by virtue of their system design and function, inherently embody profitability and economic efficiency, requiring the trustor to realize value appreciation of the trust property and pursue profit maximization. For example, business trusts in the US, and land trusts for infrastructure development which are popular in Japan, involve the trustors investing their properties in trust companies and signing documents on risk notifications and commitments. The trust companies then abide by their fiduciary obligations to pursue profit maximization of the trust property based on benevolent and prudent management. For such types of high-appreciation and high-risk trusts, the safety of the trust property is the secondary purpose; the main purpose is to maximize profits from the trust property.

The function of expressing intentions as certainties.

In the trust system, after the trustor hands over the trust property to the trust, the property can be used to respond to changes in subjective circumstances, such as the trustor's loss of intention or death. The trustee will continue to manage or dispose of the trust property based on the purpose of the trust when it was established by the trustor, in order to achieve the goal of long-term management of the trust property (Arai, 2008). When a trustor is unable to express intent or accept the expression of intent, or unable to recognize the effects of their expression of intent due to a mental disorder or any other mental impairments that limit their abilities, they must still bear the risk of the guardian's morality even after the court has declared guardianship. That risk is reduced if the trust system is used in advance to transfer the trust property to be managed by a professional and trustworthy trust institution. Doing so makes certain the trustor's intention to freely dispose of the property. This not only helps those elderly who have diminished capacities or totally lost the ability at making judgments to ensure the safety of their properties but can also prevent them from engaging in unprofitable legal acts due to insufficient capacity.

The function of bankruptcy remoteness.

Bankruptcy remoteness is also known as bankruptcy exemption or distancing. In the context of the *Trust Law* and based on the independence of trust properties, bankruptcy remoteness means that when the party in the trust legal relationship has unpaid debts or is declared bankrupt, the trust property is excluded from the scope of the insolvency estate for distribution or forcible execution. Under this circumstance, the beneficiary's beneficial rights to the trust property are also independent. This independence can be applied in accordance with the law to oppose those simple contract creditors seeking repayment of debts owed by the trustor and trustee, or debts unrelated to the trust itself. The function of bankruptcy remoteness originates from the independence of the trust property,

which perfectly reflects the "locked-in effect" of the feature of independence.

Trust properties have a completely independent legal status in trust legal relationships. The general principles of the *Trust Law* state that under normal circumstances, simple contract creditors of the trustor and trustee have no right to make claims against the trust property. The beneficiary's creditors similarly cannot make such claims, although they can usually do so against the benefits portion of the trust. Under certain special circumstances of trust legal relationships such as spendthrift and protective trusts, and based on the uniqueness of the purpose of some trusts, even the beneficiary's creditors are not allowed to go after the beneficiary's beneficial rights in accordance with the law. This is because the beneficiary rights in the legal relationship of special trusts are subject to transfer restrictions based on the particularity of the purpose of those trusts.

Minimum Requirement for the Principles of Charitable Organizations: Non-profitability

It was specifically discussed earlier that CTs belong to a special type of charitable organization. Organizations such as charities and industrial associations are all non-profit corporations as stipulated in the *Measures for the Administration of Charitable Trusts* and possess the capacity for civil rights and conduct in accordance with the law. According to relevant laws and regulations, non-profitability is the primary legal feature of non-profit corporations. Naturally, non-profitability is also an important legal feature and the minimum requirement for the principles of charitable organizations, including CTs.

Connotations of non-profitability.

As charitable organizations, CTs belong to organizations that serve the public welfare and with non-profitability as their basic characteristic. The non-profit nature of charitable organizations means that their aim and purpose is to engage in charitable activities and public service, and promote the development of charitable undertakings, rather than pursue the maximization of organizational profits. It is generally believed that charitable organizations have the organizational attributes of non-profitability, and their engagement in profit-making economic activities is, to a certain extent, restricted. Unlike corporations and other profit-making organizations, charitable organizations cannot be completely engaged in profit-making economic activities, although they are not completely prohibited from doing so under the law. Moreover, even if such organizations are to engage in economic activities, their non-profit nature determines that they must comply with certain special rules such as clauses restricting distributions or principles prohibiting distributions. Thus, charitable organizations can only allocate their profits, incomes, and assets (including donations and appreciation in the value of investments) generated through their various channels in ways limited to the scope of their purpose or public welfare undertakings, in accordance with legal provisions and objectives. If they are to disband or be terminated, they must also strictly comply with the cy-près doctrine and ensure that their charitable assets continue to be passed on and used in the charity domain.

Definition of non-profitability.

It is acknowledged in both the fields of economics and jurisprudence that the definition of non-

profitability is a difficult issue to address in legislation. There are only laws or rules imposed by the relevant departments on different types of NPOs in China. After researching the legislative systems of various countries, non-profitability was identified and generalized into two different approaches by definition.

The first type of legislative approach is the principle of functionalism or functional differentiation, which refers to the form of legislation that clearly defines the specific areas of activities, in which a non-profit corporation is permitted to engage. Most national legislation upholding this theory has strictly delineated the permissible activities in detail. For example, the *Civil Code of Germany* categorizes associations as either of an economic or non-economic nature. At the same time, German theoretical circles argue that non-economic associations can engage in certain profit-making side businesses even while they pursue the purpose of non-profitability. Being involved in such side businesses within a demarcated scope of purpose is unavoidable and has no undue influence. In the US, the areas of economic activities, in which NPOs are permitted to engage generally includes "charity, employment, education, culture, folklore, religion, and science." Such areas are specified in the relevant NPO legislation of some states. For economic activities beyond the stipulated areas, the principle of not being granted preferential taxation is generally implemented. In Japan, the *Law to Promote Specified Non-profit Activities* is a special law that applies to NPOs. Non-profit activities are defined in Article 2 of that law,[①] with twelve areas of activities specified in the appendix to the law.

The second type of legislative approach is the principle of economic relationship or profit differentiation, which refers to defining the non-profit purpose by establishing the economic relationship between a non-profit corporation and its members in the legislation, rather than clearly limiting the areas of economic activities, in which the corporation can participate. After researching the relevant legislation on non-profit corporations in the US, I found that in principle, the earliest legislation generally required non-profit corporations to refrain from using profit as their operating purpose. Subsequently, with the development of social practices, the strict controls in the relevant legislation were gradually relaxed. In principle, the operating purpose of non-profit corporations is no longer strictly restricted. Instead, legal regulations are imposed on the profit distribution method, which clearly stipulate that they "do not intend to distribute corporate income." In other words, they must strictly abide by the principle that distributions are prohibited.

Comparing the two methods of defining non-profitability, I believe that the principle of economic relationships is more in line with the actual trends, by which CTs and other charitable organizations have developed. For these, the specific meaning of non-profitability encompasses three aspects. The first is the non-profit nature of the legislative purpose. In the context of the *Civil Code of the PRC*, the final, or ultimate, goal of non-profit corporations is not to seek profit or pursue profit maximization.

① According to Article 2 of the *Law to Promote Specified Non-profit Activities*, the specified non-profit activities mentioned in this law refer to those activities listed in the appendix and which are for the purpose of promoting the welfare and interests of the majority of unspecified persons.

The second is the strict adherence to the principle that distributions are prohibited. This principle means that charitable organizations including CTs cannot distribute their assets or residual income (profits) in any form among their members under any circumstances. The third is the strict implementation of the cy-près doctrine, through which the assets of charitable organizations (including CTs) must not be converted to private property in any form.

The laws of various countries basically adopt the same attitude toward the remaining properties of non-profit corporations, namely the application of the cy-près doctrine. When a non-profit corporation is dissolved or terminated, all its remaining properties must be transferred to other public departments (in the government or other non-profit corporations) with the same or similar purposes and functions. This is to be executed by the competent authority in accordance with relevant procedures to ensure that the properties continue to be used in similar areas. This principle indicates that charitable organizations and other non-profit corporations cannot emulate the practice of for-profit companies where profits and assets are distributed among their shareholders, nor can they transfer the properties to individuals or other for-profit organizations.

Defining non-profitability this way is equivalent to directly indicating that NPOs such as CTs are permitted to engage in profit-making economic activities. In practice, charitable organizations including CTs are indeed active in a wide range of commercial fields, engaging in economic activities to generate income to serve their purposes. However, there is the issue of unfair competition when for-profit corporations engage in profit-making economic activities in the same or similar fields as non-profit corporations. The countries concerned generally regulate and modulate the former through clear tax legislation. Taking the US as an example, the economic activities of NPOs are divided into related and unrelated business activities based on the purpose of non-profit corporations. Related business activities refer to the legal economic activities that are engaged in and are closely related to the purpose of a non-profit corporation; unrelated business activities naturally refer to those economic activities that are not associated with the non-profit corporation's purpose. For the latter, there will generally be adjustments in the tax legislation including the collection of "income tax on businesses not related to the corporation's purpose." This form of legislation also exists in Germany.

From the analysis of regulations on NPOs (including CTs) enacted by various countries around the world, it is evident that for CTs, a special form of charitable organization and NPO, the natural boundary between profitability and non-profitability is not antagonistic or separate. Also, there are the double contradictions that CTs face in this situation: They have to use their non-profit characteristic to maintain and demonstrate their public welfare and charitable nature, and they tap into their for-profit characteristic to sustain the trust's function, especially the realization of value appreciation.

Absolute public welfare nature of CTs.

Unlike NPOs, CTs as a form of charitable organization not only have a non-profit nature but also have another essential attribute that differs from the NPOs: the absolute public welfare or charitable nature of the trust's purpose. Undoubtedly, any organization or individual can engage in charitable activities or public welfare undertakings. Generally, NPOs may also concurrently engage in charitable

and public welfare activities while achieving their own organizational purpose. To a certain extent, NPOs have public welfare attributes, although that is just a secondary attribute as in the case of industry associations. However, CTs are fully directed at society's public interests and must staunchly adhere to purely charitable purposes. This is the biggest difference between CTs and other types of trusts and NPOs. Public welfare represents the core value of CTs and is their essential attribute. The word "charity" in the name of a CT implies a requirement for the legitimacy of absolute public welfare. The purpose of that trust must be absolutely related to public welfare or charity, and that is the most fundamental principle and requirement.

The absolute public welfare nature of CTs can be explained from the following three aspects: (a) their purpose must be and can only be charity-related, and they must strictly abide by the types and scope of charities as stipulated by law; (b) their establishment must be based entirely on public welfare, and their purpose of being established is to realize and enhance public welfare; and (c) the mixing in of any form of private interest is absolutely prohibited, and they must have the nature of absolute public welfare.

Regarding the definition of public welfare in CTs, the legislative experience in the UK is worth learning and thinking about. English law clearly stipulates that CTs must be for the interests of an unspecified public and cannot be mixed with any form of private interests. It clearly requires that the objective of the CTs is to benefit the public society. At the same time, the *UK Trust Law* has introduced two other rules for making a judgment. The first rule is to judge whether the beneficiary meets the requirements of charity, either belonging to an unspecified public within the society or a part of it, and that the eligible beneficiary can be further selected and determined based on the trust documents. The second rule is to judge whether the trustor's charitable purpose contains any private relationships or interests between the trustor and the beneficiary.

According to these two rules, if there is a private point of connection between the trustor and the beneficiary when the trust is established, the requirement of being a part of the public within the society is not met regardless of the number of beneficiaries, unless it is clearly stipulated otherwise in the law. In this scenario, the trust does not have a public welfare nature. The definition and judgment rules of public welfare in the *UK Trust Law* indicate that public welfare is absolute, and it is this feature that highlights the core value of CTs. Absolute public welfare is demonstrated by the fact that the CT property or proceeds cannot be used for any private purposes under any circumstances and can only be utilized for strictly charitable purposes.

Public welfare is the core value of CTs. The public welfare of society that is embodied in CTs determines that their functions and goals are charitable and that they are designed to engage in charitable activities. However, the function and goal of the trust system is to manage trust properties reasonably and appropriately, realize the preservation and appreciation of those properties, and pursue efficiency maximization. The process and purpose of this system are all for-profit. CTs are a hybrid of charitable organizations and trusts. Under the joint tension of public welfare and profitability, CTs subtly reveal their unique dual attributes in terms of rights and interests.

Dual Nature of CT Supervision

Dual Attributes of the Regulatory Body and Its Norms

CTs have the dual attributes of charities and trusts. When it comes to the supervision of CTs, the Charity Law clarifies that China's Ministry of Civil Affairs (MCA) is the overall administrative and management authority. However, CTs are also public welfare trusts, which are specifically stipulated to be administered under the *Trust Law*. Furthermore, most of the CT trustees are trust companies. This being the case, the China Banking and Insurance Regulatory Commission (BIRC)—the statutory regulatory body of trust institutions—has the right (at least in legal terms) to supervise CTs while supervising trust companies. CTs in China are under the joint supervision of the MCA and BIRC, which means dual supervision. Specifically, although the MCA is the main regulatory and competent authority for CTs, the BIRC also has certain regulatory powers over CTs as stipulated in the relevant regulations of the *Trust Law*. This is indirectly demonstrated by the BIRC's supervision of trust companies, which are the trustees of CTs. Article 67 of the *Trust Law* stipulates that trustees shall comply with the obligation of statutory reporting.

In my review, the current supervision of CTs by the BIRC is generally supplementary and incidental in nature, and the commission does not have additional or dedicated supervision over CTs. Its powers to supervise CTs are mainly demonstrated as follows: (a) the power to require trust companies to submit reports. Trust companies shall submit a detailed report on the handling of the CTs' affairs, financial status, and other related matters at least once a year; (b) the power to grant approval and publish notices. After the trustees have conducted an internal review of the relevant reports, the reports shall be submitted to the regulatory authority for approval. The reports shall be made public for the acceptance of social supervision. Here, submission for approval by regulatory authorities should include both the MCA and BIRC. After all, CTs are a product category implemented by trust companies. Like other trust products, the BIRC has the power to review and supervise related reports in accordance with the law; and (c) on-site inspections. The BIRC has the right to conduct on-site inspections of trust companies that are CT trustees and to exercise its inspection powers. The scope of an inspection generally includes the status of the trustees' execution of CT affairs, management and disposal of CT assets, and financial and account statements. When problems are identified, the BIRC has the right to request trust companies to make a remedy immediately.

Since there are dual supervisory bodies, the modulating norms also have dual attributes, which are known as the heterogeneity of modulating norms. Half of the rules governing trust relationships are civil in nature, but many rules governing CTs and other special trusts belong under administrative norms. It is generally believed that the Charity Law is under the social law system, whereas the *Trust Law* is under the typical commercial law system. There are many heterogeneous regulations in the legal regulation system for CTs. They first belong to charitable organizations under the NPO umbrella

and must be modulated by the social law system represented by the Charity Law and other NPO-related laws. Being both a trust and a charitable organization, a CT is modulated by the traditional administrative, civil, and commercial laws, such as the *Trust Law*, *Tax Law*, *Administrative Law*, *Administrative Reconsideration Law*, and *Civil Procedure Law*. Although there is considerable overlap between the scope of CTs and that of public welfare trusts as stipulated in the *Trust Law*, the value orientation of the institutional system supporting CTs differ from that of other trusts.

Concerning the modulating norms, the Charity Law has made significant breakthroughs and innovations in the provisions on CTs compared with that in the *Trust Law*. These innovations have enhanced the flexibility and operability of establishing CTs. Looking at the legislative intent of the Charity Law, CTs emphasize the non-governmental and voluntary nature of charitable activities, protect the legitimate rights and interests of participants in charitable activities, and reduce the administration's power to interfere with the charitable wishes of CT trustors. The Charity Law was legislated earlier than the *Trust Law*. As a result, its regulations on CTs have fallen behind the development of actual practices. The provisions on public welfare trusts in the *Trust Law* are more principled, focusing on the government's development of public welfare undertakings, emphasizing its supervision of trusts, and the interventions of public powers. With CTs being positioned as having dual attributes, and the *Charity Law* and the *Trust Law* having similar legislative levels but substantially different legislative value orientations, conflicts over which legislation takes precedence are inevitable during the applications of the laws.

Dual Attributes of Registration

No matter the specific method adopted when a CT was established, the method must have been and can only be in a written format. This is determined by the public welfare nature of CTs and is also the usual practice in the trust legal systems of various countries. Article 8 of the *Trust Law* stipulates that "written form shall be adopted for the establishment of a trust." and Article 45 of the Charity Law stipulates that "Written form shall be adopted in the formation of charitable trust." Article 13 of the Measures on the Administration of CTs also has the same provision, namely that "written form shall be adopted in the formation of charitable trust and determination of the trustee and the supervisor."

Arising from the differences in legal sources and legislative concepts, the two major jurisdictions have varying legislative rules and requirements regarding the key issue of the effective procedures for establishing CTs, each with its own leniencies and emphases. The registration and licensing doctrines are followed by Common and Civil Laws, respectively, when determining the effective establishment of CTs. Article 62 of the *Trust Law* stipulates the regulations for the establishment of CTs.[①] The contents clearly show that the *Trust Law* follows the licensing doctrine. However, the provisions of the

① Article 62 of the establishment of a public trust and the appointment of trustees shall be subject to the approval of the regulatory agency of relevant public undertakings (hereinafter referred to as regulatory agency of public undertakings for short). One must not conduct activities in the name of public trust without the approval of the regulatory agency of public undertakings.

Charity Law are different: According to the provisions of Article 45, the implementation of CTs in China is based on the filing doctrine.[①] Articles 15, 16, and 17 of the *Measures on the Administration of CTs* also clearly stipulate that CTs should be filed in accordance with the filing procedures. Further, the Charity Law clearly stipulates that the establishment of CTs in China is based on the practice of the filing doctrine. Legislatively, this method enhances the proactiveness and flexibility of the CT parties, and indirectly breaks through some of the unfavorable constraints in the *Trust Law*. This system straddles the registration and licensing doctrines and thus, has dual attributes.

Registration doctrine of Common Law.

The Charity Commission for England and Wales, established in Britain after the promulgation of the 1960 *Charity Act*, is a statutory body that is solely responsible for the registration of CTs. As the overall and independent competent authority for charitable organizations including the nation's CTs, the commission's substantive doctrine for reviewing the registration of CTs focuses on checking "whether their activities are in line with charitable purposes, especially whether the activities are indeed for the propose of being verified as being of a public welfare nature," as well as the trustees' fiduciary qualifications. After reviewing the application and registration materials, the commission provides one of the following three opinions, namely "registration is approved, amendments to the application materials are proposed, and registration is not approved" (Halloran, 2007). For rejected applications, the trustees can lodge an appeal with the High Court if they have any objections, and the court will make the final decision.

In the US, the registration of CTs is the trustee's statutory obligation, and the process is usually under the jurisdiction of the respective state attorney general. The National Association of Attorneys General passed the *Uniform Supervision of Trustees for Charitable Purposes Act* in 1954, which clearly stipulates the requirement for CTs to be registered: "Trustees of CTs in the US must deal with matters as prescribed by the state attorney general. Within 6 months from the takeover of the trust property, trustees are to submit a registration with the state attorney general and attach a photocopy of the trust documents" (Zhou, 1997). The requisite registration contents include "the name and presence of the trust, the identity of the trustee, the property held by trust, and the purpose of the trust" (Gao, 2010).

The registration doctrine of Common Law is one of post-registration, to be carried out after the establishment of the CT. Although the registration system still needs to be reviewed by the competent authority, registration is not a legal requirement for the effective establishment of a CT, and its registration or lack thereof in no way affects its establishment. If the CT is not registered in accordance with the law after its establishment, it only indicates that the CT trustee has violated certain statutory obligations. This may lead to certain legal liabilities, but it does not affect the effective establishment of the CT, nor will the CT itself be invalidated or revoked.

① Article 45 of the Charity Law stipulates that written form shall be adopted in the formation of charitable trust and determination of the trustee and the supervisor. The trustee shall, within seven days as of the conclusion of charitable trust documents, submit the relevant documents to the civil affairs department of the people's government at or above the county level at the place where it is located for recordation.

Licensing doctrine of Civil Law.

The licensing doctrine is also known as the administrative licensing or reviewing doctrine. Its core tenet is that prior review and approval from the administrative authority is required. In the context of CT establishment, this doctrine means that "when a CT is established, an application should be submitted to the relevant state agency (the agency managing public welfare undertakings). It is only after a CT is registered that it is deemed to be established" (He, 2005). For countries and regions under Civil Law system, the licensing doctrine is generally adopted for the establishment of CTs. A CT is not established unless administrative approval is obtained from the relevant government agency. Without approval, a CT is not legally established or effective, and its establishment is rendered invalid. According to the provisions of Article 62 of the *Trust Law*, Article 258 of the *Japanese Trust Act*,① Article 66 of the *Korean Trust Act*,② and Article 70 of the *Trust Act of the Taiwan region of the PRC*,③ the trustee of a CT shall apply to the administrative and competent authority for approval in accordance with the law when the CT is established; otherwise, it shall not be valid.

A major reason for countries and regions under Civil Law system to implement the licensing doctrine is that "the licensing for CT establishment is a license for the trustee to undertake the trust rather than for the trustor to establish the trust" (Lin, 2004). The fundamental logic is that since public welfare trusts (including CTs) are directed at the public welfare of society, the corresponding beneficiaries should belong to the public or be a part of it. However, a trustor is sometimes also a member of the public. Under this circumstance, the so-called public of the society is no longer a specific social group, which renders it difficult for the trustee to be clearly and effectively supervised. Thus, it is necessary for the government agencies and authorities to implement a strict review and approval system to ensure advance supervision and prevention.

China's system innovation: filing doctrine.

Judging from the regulatory provisions of Article 62 of the *Trust Law*, the establishment of a public welfare trust in China should be approved in advance, meaning that the licensing doctrine is being practiced. The same article also stipulates that the "agency managing public welfare undertakings" is responsible for reviewing and approving the establishment of a CT. However, the agency referred to here has not been clearly specified in the regulations, much less the agency's specific powers and responsibilities. For a long time, this uncertainty, over which is the relevant competent authority, and the lack of clarity over its jurisdiction have posed difficulties to the establishment of CTs in China, and form the biggest bottleneck hindering the development of CTs in the country. By introducing innovative provisions that differ from both the licensing and registration doctrines, the original provisions of the *Trust Law* were revised in the Charity Law. This way, the licensing doctrine for the establishment of CTs as regulated under the original *Trust Law* was replaced by the filing doctrine as

① Article 258 of the *Japanese Trust Law* stipulates that "the trustee shall obtain the approval of the competent government authority when accepting a CT."
② Article 66 of the *Korean Trust Law* stipulates that "the trustee must obtain the permission of the competent authority when accepting a CT."
③ Article 70 of the *Trust Law of the Taiwan region of the PRC* stipulates that "the establishment of a CT and its trustee shall be approved by the competent authority overseeing the purpose of the undertaking. The application for permission as stated in the preceding paragraph shall be made by the trustee."

practiced under the current Charity Law.

In Article 45 of the *Charity Law* and Articles 15, 16, and 17 of the *Measures on the Administration of CTs*, the provisions clearly stipulate that CTs in China shall be filed for notice when being established. In addition, the filing authority, procedures, and responsibilities (consequences) are also made clear. The Charity Law and Measures on the Administration of CTs set out detailed regulations on the administrative filing of CTs, including the party responsible, counterparty, related matters, time limits, and reviews. These made explicit the filing doctrine system applicable for CTs in China. After a comparative analysis of the registration doctrine of Common Law and the licensing doctrine of Civil Law, and taking into account the relevant spirit of charity legislation in China, the country's innovative vetting method based on the filing doctrine can be said to be a formal review. Specifically, the vetting is to check whether the filing procedures are complied with and that the submitted materials are complete, as well as the authenticity and legality of the materials filed in accordance with formality. However, there is no substantive examination on the authenticity and defects of the contents of the materials filed. If the applicant has provided a complete set of relevant materials as stated in the filing list in compliance with the law, the MCA should in principle accept the filing.

After comparing and analyzing the registration and licensing doctrines of the two major jurisdictions and the innovative filing doctrine implemented in China, it is apparent that China's doctrine is different from the other two. To a certain extent, it can be said that the filing doctrine practiced in China is a form of "intermediate system between licensing and registration" (Yang, 2016).

Summary

CTs have the dual attributes of public welfare (non-profitability) and profitability. Charity focuses on public welfare and non-profitability, whereas trusts pursue profitability and efficiency maximization. CTs not only emphasize the trusts' function of value appreciation in financial management but must also adhere to the charitable nature of public welfare. Therefore, in addition to using the traditional charity and trust governance theories as the basis when studying CTs, it is also necessary to study and analyze some of the special attributes by combining the two subjects. The combination can be used as a basis for theoretical explanation and analysis, and to construct and improve the governance mechanism under the dual attributes. As far as social governance is concerned, the types of governance mechanisms that exists are a reflection of the governance technology used by the country to intervene in the functioning of society. All types of charitable organizations, including CTs, are important participants in social governance and represent a new force that must not be ignored.

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