



THE UNIVERSITY OF TOKYO

The University of Tokyo Business Law Working Paper Series  
No. 2021-E-02

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Historical Contexts and Future Challenges**

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May 2021

*Forthcoming in Ying Khai Liew and Matthew Harding (eds),  
Asia-Pacific Trusts Law: Theory and Practice in Context (Hart Publishing)*

The University of Tokyo  
Graduate Schools for Law and Politics

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The Transformation of Japanese Trust Law and Practice:  
Historical Contexts and Future Challenges

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<Abstract>

*Japan is one of the earliest civil law jurisdictions that introduced common law trust by statute. The Trust Act of 1922 was enacted as Japan's first comprehensive trust legislation. Since then, trust has been used mostly for commercial purposes. Today, commercial trust is a zillion yen industry.*

*The new Trust Act, which was introduced in 2006 to replace the 1922 Act, reform was primarily motivated by the desire to increase flexibility of trust law to meet the needs of the increasingly complex commercial trust practices. Nevertheless, the 2006 Act contained several provisions that expressly authorize the use of trusts for succession planning. With the rapid aging of the Japanese society, the past decade has seen growing interests in what are commonly known as 'family trusts,' where the settlor looks to his family or friends to serve as trustee to manage his or family assets or oversee succession.*

*This paper will proceed as follows. Part I will provide historical overview of Japanese trust practices, and introduce some of the major commercial uses of trusts. Part II will discuss the recent rise of family trusts and some of the issues that they brought about. Against the historical background, Part III will attempt a doctrinal exposition of some of the major doctrine of trust law, with some speculation on what changes might be visible on the horizon. Part IV will look at some of the challenges that Japanese trust practice is facing in cross-border contexts.*

## Introduction

Japan is one of the earliest civil law jurisdictions that introduced common law trust by statute.<sup>1</sup> The Trust Act of 1922 was enacted as Japan's first comprehensive trust legislation. Since then, trust has been used mostly for commercial purposes. Today, commercial trust is a zillion yen industry. According to the latest statistics published by the Trust Companies Association of Japan, the trust property held by trust banks amount to 1,201.9 trillion yen as of March 2019.<sup>2</sup> 79.3% of those assets are held in custodial capacities, and 10.3% in managerial capacities.

In 2006, the new Trust Act was introduced to replace the 1922 Act.<sup>3</sup> The reform was primarily motivated by the desire to increase flexibility of trust law to meet the needs of the increasingly complex commercial trust practices. Nevertheless, the 2006 Act contained several provisions that expressly authorize the use of trusts for succession planning. With the rapid aging of the Japanese society, the past decade has seen growing interests in what are commonly known as 'family trusts,' where the settlor looks to his family or friends to serve as trustee to manage his or family assets or oversee succession.

This paper will proceed as follows. Part I will provide historical overview of Japanese trust practices, and introduce some of the major commercial uses of trusts. Part II will discuss the recent rise of family trusts and some of the issues that they brought about. Against the historical background, Part III will attempt a doctrinal exposition of some of the major doctrine of trust law, with some speculation on what changes might be visible on the horizon. Part IV will look at some of the challenges that Japanese trust practice is facing in cross-border contexts.

### I. Historical reception and commercial uses

#### (1) Reception of Trust and Trust Act of 1922

The introduction of common law trust in Japan goes back to the beginning of the twentieth century. The initial motive was to introduce foreign capital by adopting mortgage trust as used in financial markets in the U.S. and the U.K.. In 1905, the Secured Bond Trust Act<sup>4</sup> was enacted to facilitate collateral bond issues by authorizing trust companies to hold and manage

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<sup>1</sup> During the 1920s, Liechtenstein, Mexico and Panama also introduced trust law by legislation. KW Ryan, 'The Reception of the Trust' (1961) 10 *International and Comparative Law Quarterly* 265, 265.

<sup>2</sup> Trust Companies Association of Japan (TCAJ), 'The Overview of Trusteeship as of March 2019' (2019) 279 *Trusts* 94, 94.

<sup>3</sup> Makoto Arai, 'Japan' in Alon Kaplan ed., *Trusts in Prime Jurisdictions* (4th edn 2016) 255, 270. For general over view of Japanese trust law, Masayuki Tamaruya, 'Japanese Law and the Global Diffusion of Trust and Fiduciary Law' (2018) 103 *Iowa L Rev* 2229; Makoto Arai, 'Trust law in Japan: inspiring changes in Asia, 1922 and 2006', in Lusina Ho & Rebecca Lee (eds), *Trust Law in Asian Civil Law Jurisdictions* (2013) 27.

<sup>4</sup> Secured Bond Trust Act, Law No. 52 of 1905.

certain corporate assets in trust as collateral. Between 1923 and 1931, Japanese electricity companies issued bonds in the New York and London, with 16 issues of 22.8 million U.S. dollars and 9.9 million pounds in total.<sup>5</sup>

In 1922, a comprehensive trust legislation was introduced. The Trust Act of 1922 was drafted with reference to the Indian Trust Act and California Civil Code, as well as the trust law as was then found in English case law.<sup>6</sup> At the time, there was no felt need to use trust to manage family assets across generations. In fact, the primary motive of the Trust Act, along with its regulatory counterpart, Trust Business Act, was to regulate the trust companies, many of which sprang up shortly after the 1905 Act but often engaged in shadowy business of land speculation and loan sharking.

Japanese commercial trust practice and industry regulation was imposed in Korea and Taiwan, which Japan ruled as colony until its defeat in World War II. Although the direct rule ended in 1945, similar patterns of commercial trusts and statutory provisions can be found in South Korea, Taiwan, and to some extent mainland China.<sup>7</sup>

## (2) Post-WWII development and commercial trusts

Commercial uses continued to dominate the post-war trust practices in Japan. Trust banks were the exclusive provider of trust services until the entry requirement was gradually relaxed in 1985 and onward. Shortly after the war, the main services of the trust banks were money trusts, where trust companies would accept funds from a large number of investors and administer those funds by making long-term loans to the heavy industries. As the economy become matured, the trust was put to increasingly complex commercial transaction.

*Money trusts and loan trusts:* The dominant form of money trust during the early post-war years was known as loan trust, a Treasury-supervised form of collective investments authorized under legislation in 1952.<sup>8</sup> The loan trust worked just like a bank deposit, where trust contract routinely guaranteed the return of capital and expected dividend.<sup>9</sup> Both policymakers and trust bankers were aware that loan trusts were not the proper form of trusts; they were intended as temporary crisis-avoidance measure. Nevertheless, the product was popular among the middle-

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<sup>5</sup> Takeo Kikkawa, *The Development of Japanese Electric Industry and Matsunaga Yasuzaemon* (1995) 104–35.

<sup>6</sup> Stelios Tofaris, ‘Trust Law Goes East: The Transplantation of Trust Law in India and Beyond’ (2015) 36 *J of Legal History* 299, 323–26.

<sup>7</sup> Lusina Ho & Rebecca Lee, ‘Reception of the Trust in Asia: An Historical Perspective’ in Lusina Ho & Rebecca Lee (eds), *Trust Law in Asian Civil Law Jurisdictions* (2013) 10, 25–26.

<sup>8</sup> Loan Trust Act, Law No. 195 of 1952

<sup>9</sup> Takanori Kamibayashi, ‘The Rise and Fall of Loan Trusts and the Future of Trust Banks’ (2000) 68(2) *Keizai Shirin* 247, 253.

class population, fulfilling the stated purpose of ‘facilitat[ing] ordinary investors’ financing of the industries and thereby contribut[ing] to the continuous long-term supply of funds to the exploitation of natural resources and other industrial activities.’<sup>10</sup>

Until 1980s, funds accumulated by loan trusts dwarfed other categories of assets, with total assets hitting the peak of 50.7 trillion yen in 1993.<sup>11</sup> As the trust industry began to engaged in more complex trust transactions in the 1980s, the share of loan trust declined. By 2000s, trust companies ceased to manage any loan trust. Nevertheless, the loan trust set the tone of Japanese commercial trust practices where it served the broad cohort of middle class in the form of collective investment. Even today, tailor-made money trusts are used as a vehicle for collective investment, with 125.2 trillion yen held in money trusts in 2019.<sup>12</sup>

*Investment trust:* Although initially dwarfed by loan trust, investment trust became increasingly important in the trust industry. Modelled after unit trusts in England, investment trusts are a collective investment mechanism using trusts that allows relatively small-scale investors to access broad range of securities under management by investment specialists. The first investment trust certificate was issued in 1941.<sup>13</sup> Securities investment trusts were created on the basis of the Trust Act until 1951, when special legislation was enacted to provide regulatory framework.<sup>14</sup> The total assets held in investment trusts hit its initial peak of 57 trillion yen in 1989, but with the collapse of the bubble economy decreased to 38 trillion yen in 1997. From then, the amount grew more than five times to reach 209.9 trillion yen in 2019.<sup>15</sup>

*Pension and employee benefit trusts:* By 1960s Japanese business corporations had begun to offer pension payment upon employees’ retirement. Tax law was amended to provide favourable treatment to qualified pension plans.<sup>16</sup> Trust banks serving for pension plans offer a range of services, which include the investment and management of the pension assets, the design of pension structure and actuarial computation, ensuring compliance with regulatory rules, and distributing a range of benefits to employees and retirees. Although the recent years have seen a series of reforms in the pension system, the total amount under administration in pension trusts has been relatively stable for the past 15 years, ranging from 72 to 86 trillion yen, with the latest figure being 82.0 trillion yen in 2019.<sup>17</sup>

*Real estate trust and land trust:* In the late 1970s the trust banks began to accept greater

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<sup>10</sup> Loan Trust Act, § 1.

<sup>11</sup> Kamibayashi (n 9) at 258–60.

<sup>12</sup> TCAJ (n 2), at 95.

<sup>13</sup> Nomura Securities Research Department, *Empirical Studies of Investment Trust* (1942).

<sup>14</sup> Securities Invest Trust Act, Law No 198 of 1951, renamed by Law No 97 of 2000 as Investment Trust and Investment Corporation Act.

<sup>15</sup> TCAJ (n 2), at 95.

<sup>16</sup> Qualified retirement pension was recognized in 1962, and welfare pension fund in 1966.

<sup>17</sup> TCAJ (n 2), at 95.

varieties of property that required complex management. One such example is called real estate trusts, in which the trust bank receives the transfer of real estates from the settlor and manages and administers them to distribute income during the duration of the trust and return the assets upon termination. Land trusts, which involves more extensive development of land, construction of facilities and administration of enterprises, began in 1984 to explore the then-rising property value.<sup>18</sup> However such trusts were hit hard by the collapse of economic bubble in 1990.<sup>19</sup>

One such land trust reached the Supreme Court in *Mitsubishi UFJ Trust Bank v. Hyogo Prefecture*.<sup>20</sup> In 1987, Hyogo Prefecture, a local government in the western part of Japan, conveyed its real property to Toyo Trust Bank, so the bank would hold the real property in trust for the benefit of the local government. Under the trust contract, the trust bank was to develop and maintain recreational facilities upon the land while providing financing to the project by mortgaging the trust property. Unfortunately, the property price depreciated in the 1990s, and the operation began to lose money and accumulate debts far exceeding the value of the trust property. The trust bank paid off the debt and issued proceedings against the beneficiary to seek reimbursement of expenses. The Japanese Supreme Court ruled for the plaintiff, holding that the relevant contract provision invoked by the defendant beneficiary did not specifically excluded the plaintiff's right to compensation as provided in the 1922 Trust Act.<sup>21</sup>

Following the 2006 reform, the trustee can be reimbursed from the beneficiary only upon agreement.<sup>22</sup> In the meanwhile trust banks have ceased to undertake trusteeship that involve active management of enterprise. The need for such service was taken over by the securitization involving real estates.

*Securitization:* In 1980s, Japanese financial institutions and business corporations began to issue securities on the back of segregated assets held in trust. This mechanism is attractive for businesses wanting to obtain cashflow on the basis of the value of their illiquid assets and improve their financial position. Typical examples are securitization of loan credits held by financial institutions and securitization of sales credits held by business corporations. Securities backed by real property have also been sold to investors in the real estate investment trust market. As of 2019, assets under securitization is 80.5 trillion yen, of which 36.5 trillion yen involved chose in action, and 40.3 trillion yen involved real estates.<sup>23</sup>

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<sup>18</sup> Symposium, 'Land trusts set in motion' (1984) 827 Jurist 6.

<sup>19</sup> 'The Basics of "Real Estate Trusts"' (2012) 1940 Kin'yu Homu Jijo 56, 57.

<sup>20</sup> *Mitsubishi UFJ Trust Bank v Hyogo Prefecture*, 2136 Hanji 30 (Supreme Court, Nov. 17, 2011).

<sup>21</sup> Trust Act 1922 § 36(2) as then applicable provided that when the trustee paid out tax or other expenses or suffered loss during the course of trust administration without any fault on his part, he shall be entitled to exercise his right to compensation.

<sup>22</sup> Trust Act 2006 § 48(5).

<sup>23</sup> TCAJ (n 2), at 95.

Although Japan was following the U.S. model of mortgage-backed securities in the 1970s, creating a hospitable environment for securitization was difficult well into 1990s.<sup>24</sup> Just to name a few legal impediments, perfecting the transfer of loan and receivables was a complex and costly process; establishing special purpose vehicle used for securitization was also costly; and the beneficial interest could not be recognized as securities under the securities legislation at the time. While a series of special legislation was introduced to overcome each of these impediments, the discontent created an impetus to reform the trust legislation. The Trust Business Act was reformed in 2004<sup>25</sup> and Trust Act was overhauled in 2006.<sup>26</sup>

### (3) The 2006 reform and its implication

The new Trust Act represented a wide-ranging reform. As explained in detail in Part III., the reform newly allowed declaration of trust, rearranged the provisions on duty of loyalty, and allowed the trustee to delegate his administrative responsibility. The Act sought to keep the law up to date with commercial trust practices by introducing limited liability trust, authorizing securitization of beneficial interests, and introducing optional provisions on majority voting by multiple beneficiaries, as well as introducing trust-related offices such as trust enforcers and beneficiary representatives.

*Security trust:* Trust Act of 2006 also allowed the trustee to hold security interest separately from the main debt.<sup>27</sup> By holding securities for the benefit of the multiple lenders for instance in syndicated loans, the trust banks can expect to increase efficiency in managing the collateral, and reduce paperwork when the creditors transfer their choses in action.

*Will-substitute and successive beneficiaries trusts:* At the same time, the 2006 Act contained provisions that expressly authorize the use of trust commonly observed in common law jurisdictions. One can make a will-substitute trust, where the settlor can receive benefit from the trust during his life, and upon his death, the benefit would shift to whoever he designates as beneficiaries.<sup>28</sup> One can also create a trust with successive beneficiaries, where a particular beneficiary's beneficial interest ceases upon his death and another beneficiaries' interests arise as stated in the trust.<sup>29</sup> In 2009, trust banks began to accept such trusts.<sup>30</sup>

Will-substitute trusts became quickly popular. 160,020 such trusts were created by

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<sup>24</sup> Hideki Kanda, 'Securitization in Japan' (1998) 8 Duke J. Comp. & Int'l L. 359.

<sup>25</sup> Trust Business Act, Law No 154 of 2004.

<sup>26</sup> Trust Act, Law No 208 of 2006.

<sup>27</sup> Trust Act § 3(i)(ii).

<sup>28</sup> Id § 90. Similarly to American revocable trust, the settlor has the right to modify the trust during his life. See Uniform Trust Code §§ 601-603.

<sup>29</sup> Id § 91.

<sup>30</sup> Megumu Teramoto, 'Recent Development on Will-Substitute Trusts' (2014) 2 Trust Forum 57, 58-59.

2019.<sup>31</sup> In 2013, the government began to provide tax incentives for certain categories of lifetime gift-giving, and trust banks now offer qualifying trust products. Between 2013 and 2019, 220,598 qualifying trusts were created for funding education expenses with total assets of 1.59 trillion yen.<sup>32</sup> Between 2015 and 2018, 5,343 qualified trusts with assets totalling 15.1 billion yen were created to prepare for marriage and childrearing.<sup>33</sup> Because the tax exemption is limited to gifts up to 15 million yen (equivalent to USD 140,000) and 10 million yen respectively, the scale of these trusts is inevitably limited, making them more attractive to middle class senior citizens than to high net-worth individuals.

## II. Family trust and charitable trust

### (1) The rise of family trusts

The impact of the 2006 Act was not limited to the world of trust banks. As the reform removed doubt as to legality of trans-generational use of trusts, property owners began to look to trusts for the purpose of managing and succeeding their family assets. In many such trusts, someone among settlor's family members serve as a trustee, who are in turn aided by professional advisors.<sup>34</sup> The rise of family trusts coincided with the rapid aging of the Japanese society, with a flurry of legislative reform taking place in the area of guardianship and succession law. Notably, the reform of guardianship system had created a near-crisis situation, where the family courts around the country were experiencing serious difficulty monitoring guardians and preventing abuse.

The increase of family trusts in the 2010s gave rise to a number of disputes created by hastily prepared trusts. Only a decade ago, trusts were exclusively undertaken by trust banks under the financial regulator's auspices and rarely made their way to court. Suddenly the court is asked to rule on some of the basic issues of trust law.

In *Holographic Will Trustee v Ueno Department Store* (2016), for instance, the court made a strenuous effort to give effect to a holographic will that the decedent created a few weeks before death to disinherit one of her heirs.<sup>35</sup> The trust asset consisted of the shares of a family company the decedent and her late husband succeeded from her father. She appointed an attorney as the trustee and executer of her will, and directed him to hold the stock in trust for the benefit

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<sup>31</sup> TCAJ (n 2), at 96.

<sup>32</sup> Id at 89. Taxation Special Measures Act, Law No 26 of 1957, § 70-2-2, inserted by Law No 5 of 2013.

<sup>33</sup> TCAJ, 'The Overview of Trusteeship as of March 2018' (2019) 279 Trusts 89, 93. Taxation Special Measures Act, Law No. 26 of 1957, § 70-2-3, inserted by Law No. 5 of 2013.

<sup>34</sup> The Prime Minister's license is required to undertake trusteeship in the course of business. Trust Business Act §§ 2(1), 3.

<sup>35</sup> *Holographic Will Trustee v. Ueno Department Store*, 2325 Hanji 41 (Tokyo High Ct. October 19, 2016).

of her younger son's son until he comes of his age. The company was in the middle of a family feud, and things went wrong shortly after the settlor's death. The company board refused to approve the share transfer, which was required in the article of incorporation. The younger son, realizing that his son's entitlement under the trust invaded the decedent's elder son's daughter's forced share, acted as his guardian and agreed with the elder son, also acting as guardian of his minor daughter, to divide the shares between the two grandchildren. The agreed share transfer was approved by the board, and the shareholders' meeting was held, where the attorney-trustee-executor was removed from the position of company's statutory auditor which he had long held.

In a civil litigation filed by the humiliated trustee, the court ruled that the purpose of the trust was frustrated when the share transfer was disapproved by the board. Rather than invalidating the trust, however, the court held that the trust terminated and the shares devolved to the younger son's son, effectively approving the transaction between the younger son's son and elder son's daughter brokered by their fathers as parent guardians. The court justified the ruling on the basis of the settlor's implied intent, but ironically it failed to achieve the settlor's objective of vesting the attorney with the shareholder's right to be exercised on behalf of her favoured grandson. The court conceded this point, but stated that the outcome was unavoidable in light of the forced heirship claim and parental capacity to act as the minor child's natural guardian, which is not present in most common law jurisdictions. While the case serves as a reminder of the difficulty of transplanting the trust into a civil law jurisdiction, one is left to wonder whether any better outcome could have been achieved had the settlor carefully planned in advance.

## (2) Trust and forced heirship

One basic question that the 2006 reform has left ambiguous is how the trust can be reconciled with forced heirship. In *Disinherited Eldest Son v. Favoured Second Son* (2018),<sup>36</sup> the Tokyo District Court for the first time squarely faced the issue. In this case the settlor conveyed all the real estates in trust so that 'the entire family assets be managed and maintained, and ritual be conducted continuously by the second son and his descendants with the overriding objective of bringing prosperity to the family.' The settlor designated himself as the life-time beneficiary, and directed that upon his death the beneficial interest shift to his children. The settlor had three children, and the second son was to receive four sixths of the beneficial interests, while the eldest son and the daughter was to receive one sixth each. Upon the death of all three children, the beneficial interests were to be distributed equally to the second son's children. The beneficiaries were entitled to receive the financial benefit that arises from the sale, lease or other disposition of the trust assets. The second son was designated trustee and was also given the right to use the trust

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<sup>36</sup> 30 Kin'yu Houmu Jijo 78 (Tokyo District Court, September 12, 2018).

assets for himself for free.

When the eldest son sued the second son, the court invalidated the trust in part and upheld the trust in part. In so doing, the court divided the trust property in two groups. The first group consisted of those assets that were unlikely to be sold or generate income, which included the family residential house valued at ¥352,415,200. Finding that this part of the trust was a disguised attempt to evade forced heirship claims, the court ruled that the trust was, to the extent that it concerned this group of assets, contrary to the public order and thus invalid. The defendant was required to transfer the co-ownership interest as to one sixth of the property. The second and remaining part of the trust assets had good prospect of generating income, mostly in the form of rent payment. Because the eldest son was entitled to receive one sixth of the beneficial interest, the court upheld this portion of the trust, rejecting his argument that the entire trust be set aside.

The court's holding made clear that forced heirship constitutes the public order under the Japanese law of succession. At the same time, the court refused to invalidate the entire trust, even if it was designed to and did infringe particular forced heirship. However, one might question whether giving one-sixth ownership to the unsaleable assets and one-sixth entitlement to the income generated from the remaining property was sufficient to protect the eldest son's forced heir entitlement. Given that he cannot leave none of the assets in the second category to his descendant, what he received was arguably much less than his entitlement to the one-sixth of his father's estate. The case reflects the conceptual and practical challenges that the Japanese judiciary had to confront with. As of writing, the case is appealed and under review by Tokyo High Court.

### (3) Charitable trust

The first charitable trust in Japan was created in 1977. Since then, charitable trusts have steadily increased both in number and in the total assets held. The total assets hit its peak in 2001, with 73.7 billion yen held in 566 charitable trusts, although the scale of philanthropy has since declined, and according to the latest figures, 438 charitable trusts held 57.1 billion yen in 2019.<sup>37</sup> Similarly to commercial trusts, trusteeship for virtually all public interest trusts has been undertaken by trust banks. Due to the strict permission standard and tax law requirement, Japanese charitable trusts now hold only cash and engage in only grant-making. However, this may change after the ongoing reform of charitable trust legislation.

In 2018, the Legislative Council for the Ministry of Justice published the General Outline of the proposed reform, laying the ground for the legislative bill to be presented to Parliament.<sup>38</sup> The General Outline proposes to broaden the trustee bases by enabling ordinary

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<sup>37</sup> TCAJ (n 2) 89.

<sup>38</sup> Ministry of Justice Legislative Council, *General Outline for the Revision of Public Interest*

individuals or corporations to serve as trustees.<sup>39</sup> The General Outline also proposes to facilitate the use of charitable trust for more extensive works than what had effectively been limited to distribution of grants or scholarship.<sup>40</sup> These proposed shifts have raised concern that the reformed charitable trusts might be susceptible to abuse. The General Outline makes a number of proposals to enhance accountability in the management of the trusts.<sup>41</sup> One of the them is the introduction of a mandatory trust supervisor (*shintaku-kanrinin*),<sup>42</sup> which had been introduced earlier in the context of non-charitable purpose trusts following the off-shore practice of trust enforcer.<sup>43</sup> In order to ensure that the trust supervisor exercises independent oversight over the trustees, the General Outline provides that the supervisor cannot be related to the trustees or settlors or to their family or employees.<sup>44</sup>

The reform of charitable trusts is intended to integrate the reform of trust law and that of non-profit organization law, both of which took place in 2006. With the rise of family trust, one would hope that the reform would create hospitable environment for charitable giving and civic activities. All this would depend on the how the charitable trust bill will be enacted and implemented.<sup>45</sup>

### III. Doctrinal exposition

Against the background of the long-standing use of commercial trusts and the recent rise of family trust, the doctrinal exposition of Japanese trust is warranted. The discussion will also attempt to put the Japanese trust law in a broader comparative context.

#### (1) Creation of trust

Trust can be created by using one of the following three methods.<sup>46</sup> The first and prototypical method is trust contract. The second is by will, which was not common while the trust was used for commercial purposes, but is now becoming more common with the rise of family trusts. The third method is by declaration, which was made available by the 2006 reform. For fear of abuse, however, the Trust Act specifically requires the declaration be made in writing

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*Trust Act* (December 18, 2018). For the drafter's account, see Yuichiro Nakatsuji, *Outline of the Interim Proposal on the Revision of the Charitable Trust Act*, 273 TRUST 152 (2018).

<sup>39</sup> General Outline § 4, at 3-4.

<sup>40</sup> *Id.* at § 9.

<sup>41</sup> *Id.* at § 5 (trust supervisor), §§ 7, 8 (administrative authorization), § 11 (disclosure);

<sup>42</sup> General Outline § 5, at 5-6.

<sup>43</sup> Trust Act §§ 258(4); 123-130.

<sup>44</sup> General Outline § 5-2(2).

<sup>45</sup> Masayuki Tamaruya, 'The use of trusts for charitable purposes: a comparative perspective' (2019) 11 Trust Forum 11.

<sup>46</sup> Trust Act § 3(i)-(iii).

with ascertainable date that complies with the Ministry of Justice's regulation.<sup>47</sup>

The fact that trust contract is considered the prototype has some important implications. First, Japanese trust law confers certain powers on the settlor. For instance, the settlor has the right to request the trustee to produce the accounting documents;<sup>48</sup> petition the court to appoint new trustee,<sup>49</sup> remove a trustee,<sup>50</sup> or issue a trust property administration order;<sup>51</sup> or agree with the beneficiary to remove the trustee,<sup>52</sup> modify the trust,<sup>53</sup> or terminate the trust.<sup>54</sup> While giving settlor control over trust administration is often controversial in Anglo-Commonwealth jurisdictions,<sup>55</sup> Japanese trust lawyers, along with other lawyers in civil law jurisdictions, have been rather sanguine about it. Japanese trust practitioners have never appeared ambitious in attracting offshore-style trust businesses.

Japanese contractarian approach was clearly influenced by Langbein's thesis that the trust can be seen as a business deal that allows flexible arrangement between the parties to the transaction.<sup>56</sup> The theory was certainly attractive to Japanese commercial trust practitioners.<sup>57</sup> Nevertheless, in civil law jurisdictions the law of contract is not regarded as a mere enforcement of the bargain struck by the parties to the contract. The courts in civil law jurisdictions is more willing to impose obligations beyond what is provided in the contractual documents both before and after the formation of the contract. In fact, the Trust Business Act does not allow exemption of trustee's duty of care liability, and this is not considered a contradiction with the contractarian notion of Japanese trust.<sup>58</sup>

If the trust asset is comprised of property subject to registration, such as real estate, automobile and patent, registration is required to assert a claim against a third party.<sup>59</sup> In the case of real property, the registration requires publication of the name and address of the settlor, the trustee and the beneficiaries, the purpose of the trust, the method of administration of trust assets,

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<sup>47</sup> Id §§ 3(iii), 4(3).

<sup>48</sup> Id § 38(6).

<sup>49</sup> Id § 62(4).

<sup>50</sup> Id § 58(4).

<sup>51</sup> Id § 63(1).

<sup>52</sup> Id § 58(1).

<sup>53</sup> Id § 149(3).

<sup>54</sup> Id § 164(1).

<sup>55</sup> Lionel Smith, 'Give the People What They Want? The Onshoring of the Offshore' (2018) 103 Iowa LR 2156.

<sup>56</sup> John H. Langbein, 'The Contractarian Basis of the Law of Trusts' (1995) 105 Yale LJ 625.

<sup>57</sup> Hideki Kanda, 'Japanese Commercial Trusts—An Introduction' in Seiichi Ochiai et al. eds., *Festschrift for Professor Tsuneo Ootori: The Trajectory and the Future of Modern Corporate Legislation* (1995) 581.

<sup>58</sup> Trust Business Act § 28(2).

<sup>59</sup> Id § 14.

the grounds for termination of the trust, and other terms of the trust.<sup>60</sup> The registration is required as a matter of domestic property transfer regime, and it predates the recent cross-border initiatives to fight against money-laundering.<sup>61</sup>

The Trust Act does not provide for what is known in common law jurisdictions as constructive trust or resulting trust. However, in *Nakata Construction Co v East Japan Construction Guaranty Co* (2002),<sup>62</sup> the Japanese Supreme Court implied a trust where none of the parties had expressed a wish to create one. The case concerned a construction company, which had received advance payment from the local government for the agreed service under a construction contract. When it went into bankruptcy before completing its work, the bankruptcy administrator sought to collect the advance payment kept in a separate bank account as part of the bankrupt estate. The defendant had paid out to the local government upon the bankrupt company's default pursuant to its guarantee obligation for the bankrupt company's provision of service. The Japanese Supreme Court rejected the bankruptcy administrator's claim and held that upon construction company's receipt of advance payment in the special account, a trust contract arose in which the recipient held the fund for the benefit of the government. The Court considered it material that under the relevant legislation and contractual arrangements, the bankrupt company could withdraw from the separate bank account only for the purpose of the specific construction work and by following designated procedures subject to the guarantee company's audit. In the absence of statutory authorization of resulting trust or constructive trust, the Japanese Supreme Court justified the trust in terms of the parties' intent. Some commentators have compared this implied trust with the English Quistclose trust,<sup>63</sup> although the exact nature of the trust may need to be rehashed as the case law develops in the future.

## (2) The nature of trust and the beneficial interest

The Trust Act defines the trust as 'an arrangement in which a specific person ... administers or disposes of property in accordance with a certain purpose (excluding the purpose of exclusively promoting the person's own interests...) and conducts any other acts that are necessary to achieve said purpose.'<sup>64</sup>

This definition characterizes the trust as a relation between a trustee and either a beneficiary or a specified purpose. The prominence of purpose is reminiscent of the definition in

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<sup>60</sup> Real Property Registration Act, Law No 123 of 2004, § 97(1).

<sup>61</sup> Ho & Lee (n 7) 23.

<sup>62</sup> 56(1) Minshu 20 (Sup. Ct., Nov. 17, 2002).

<sup>63</sup> Masami Okino, 'Public Work Advance Payment and Trust: Supreme Court Case of January 17, 2002 Re-Considered' in Yoshihisa Nomi et al eds, *Law and Policy in the Study of Civil Law: In Celebration of 70th Birthday of Professor Yoshinobu Hirai* (2007) 367, 389-411.

<sup>64</sup> Trust Act § 2(1).

the Hague Trust Convention, which characterizes the trust as ‘the legal relationships created ... 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.’<sup>65</sup> As already seen, charitable trust can be created in Japan.<sup>66</sup> Furthermore, the Trust Act contains provisions that authorize the creation of non-charitable purpose trusts.<sup>67</sup> In practice, however, for fear of abuse, the trustee of a non-charitable purpose trust can be only the national or local government or other legal persons whose net assets exceed 50 million yen.<sup>68</sup> As of writing, no non-charitable purpose trust has been created in Japan.

The nature of the beneficial interest in Japanese trust is understood as a right *in personam*.<sup>69</sup> Although this might seem a natural consequence of using contract as the prototypical form of trust creation, this was a conscious choice made by Torajiro Ikeda, the drafter of original 1922 Trust Act.<sup>70</sup> He was aware that as of his writing the issue was yet to settle even in common-law jurisdictions, and carefully reviewed the academic writings. On the one hand, those commentators who espoused the *in personam* theory sought to explain the rights of beneficiaries in conjunction with the personal obligations that trustees owed them with a limited implication to third parties.<sup>71</sup> On the other hand, those in the *in rem* theory camp emphasized the beneficiary’s proprietary entitlement that could be claimed against the world.<sup>72</sup> In his view, the *in rem* theory was appropriate for passive trusts, where trustees nominally hold the assets and beneficiaries are like owners. However, the *in personam* theory sounded more persuasive for active trusts, where trustees play an active role in managing the assets.<sup>73</sup> Ikeda’s conclusion was a practical one. He chose the *in personam* approach because he predicted that active trusts would dominate future trust practices.

There have been alternative explanations. Henry T. Terry, an American lawyer who taught at Tokyo Imperial University in the early twentieth century, professed to subscribe to the *in personam* theory but gave more nuanced analysis. In his view, the beneficiary’s right could

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<sup>65</sup> The Hague Convention on the Law Applicable to Trusts and on their Recognition § 2.

<sup>66</sup> Charitable Trust Act, Law 62 of 1922.

<sup>67</sup> Trust Act §§ 258-61.

<sup>68</sup> Trust Act Enforcement Order § 3.

<sup>69</sup> Id § 2(7) (‘The term “beneficial interest” ... means a claim based on the terms of the trust regarding the obligation of a trustee to distribute property from the trust assets ... and the right to require the trustee or any other person to act according to the provisions of this Act to secure said claims.’).

<sup>70</sup> Torajiro Ikeda, *On the Law of Trusts for Secured Bonds* (1907) 144.

<sup>71</sup> John W. Salmond, *Jurisprudence or, the Theory of the Law* (1902) 278–84; John Norton Pomeroy, *A Treatise on Equity Jurisprudence* (Carter Pitkin Pomeroy & John Norton Pomeroy, Jr. eds., 2d ed. 1901) vol 1, §§ 147–49.

<sup>72</sup> Frederick Pollock, *Principles of Contract at Law and in Equity* (7th ed. 1902) 208; Thomas Lewin, *A Practical Treatise on the Law of Trusts* (Cecil C. M. Dale ed., 10th ed. 1898) 11–15.

<sup>73</sup> Ikeda (n 70) 144.

properly be explained as ‘a claim in favour of one person upon a right held by another.’<sup>74</sup> The fact that he belonged to the analytical school and was contemporary to Wesley Newcomb Hohfeld may explain the similarity of his thesis to one of the present-day English theoretical schools that argues that an equitable property right should be understood as a right against a right.<sup>75</sup> More recently, Kazuo Shinomiya, a leading trust law scholar in post-war Japan, proposed to treat trust assets as essentially a legal entity, thereby recognizing beneficiaries’ direct entitlement to trust assets.<sup>76</sup> Part of his inspiration came from the works of a French scholar Pierre Lépaulle.<sup>77</sup> Although he stopped short of recognizing beneficiaries’ proprietary interest in trust assets, he argued that *in personam* theory failed to fully explain some of the Trust Act’s provisions that is accompanied by certain proprietary effect. They are the provisions that entitles the beneficiary to a remedy against third parties (discussed in (5) below), and those that ensure independence of the trust assets from the trustee’s own property (discussed in (3) below).

Although Shinomiya’s theory gained respect in academic quarters, ultimately the theory was seen too ambitious and lacked sufficient statutory grounds. The drafter of the reformed 2006 trust legislation clearly took the *in personam* position,<sup>78</sup> and recent scholarship does not appear so keen to pursue the doctrinal nicety. Nevertheless, there is persistent criticism against the 2006 Act that its contractarian understanding of the trust and its *in personam* view of the beneficial interest left the beneficiaries with insufficient protection of the independent property.<sup>79</sup> This argument may gain traction with the rise of family trust.

### (3) Independence of the trust property

The Trust Act recognizes that the trust assets are legally separate and independent of the trustee’s assets.<sup>80</sup> For many civil law jurisdictions attempting to introduce trust by statute, provisions that represent the independence of trust property served as the key to providing proprietary protection for the beneficiaries in the event of the breach of trust, or the death or

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<sup>74</sup> Henry T Terry ‘Lectures on Equity’ (1907) 25 *Hogaku Kyokai Zasshi* 453, 457-60.

<sup>75</sup> Ben McFarlane and Robert Stevens, ‘The nature of equitable property’ (2010) 4 *J of Equity* 1, 2.

<sup>76</sup> Kazuo Shinomiya, *Trust Law* (rev. ed. 1989) 76-77.

<sup>77</sup> Id 67-68, citing Pierre Lépaulle, *Traité théorique et pratique des trusts en droit interne, en droit fiscal et en droit international* (1931) 43.

<sup>78</sup> Masahiro Teramoto, *Commentary: New Trust Act* (revised ed 2007) 25.

<sup>79</sup> Yoshihisa Nomi, ‘Trust law in transition: for greater protection of the beneficial interests’ in Yoshihisa Nomi et al eds, *The New Era of Trust Legislation: Modern Development and Future Perspective on Trusts* (2017) 15, 15-22; Makoto Arai, *Trust Act* (4th edn 2014) 60-75.

<sup>80</sup> Trust Act § 2(3) (trust property is ‘any and all property which belongs to the trustee and which is to be administered or disposed of through the trust’); § 2(8) (trustee’s own property is ‘any and all property which belongs to the trustee and which is not the property that comes under trust property’).

bankruptcy of the trustee.<sup>81</sup>

One important mechanism that ensures the independence of the trust property is known as real subrogation. The Trust Act provides that the proceeds the trustee acquires when the trust funds are managed, disposed of, destroyed, damaged and so on form part of trust fund.<sup>82</sup> In other words, what comes into the hands of the trustee at the expense of the trust fund is substituted for the original trust assets and becomes part of the new trust fund and kept separate from the non-trust fund held by the trustee.<sup>83</sup> The beneficiary can thus make a claim on the substitute assets regardless of whether they were acquired as part of proper administration of trust or as a result of breach of trust.

The trust property carved out of the trustee's personal assets is shielded from the reach of the trustee's personal creditors. Those who became the trustee's creditor by virtue of the trustee's administration of trust can seize or execute on the trust assets, but otherwise the trustee's personal creditor cannot seize, attach, execute on, or foreclose on the trust property.<sup>84</sup> If such judicial proceedings are commenced, the trustee and the beneficiary can file a third-party action against the executing creditor.<sup>85</sup> In fact, given the trustee's fiduciary obligation, the trustee is under a duty to file such an action.<sup>86</sup>

When bankruptcy proceedings are commenced against the trustee, the trust assets do not become part of the bankruptcy estates, and remain outside the reach of the trustee's personal creditors.<sup>87</sup> In the event of the trustee's bankruptcy, the trusteeship terminates and the bankruptcy trustee owes the duty to retain the trust property and carry out necessary action for the transition to trusteeship by a successor trustee.<sup>88</sup> The trust assets remain separate from the non-trust assets in the event of the trustee's death. The trust assets do not become part of the estate, and the heirs owes the duty to notify the beneficiaries, and retain the trust property and carry out necessary action for the transition to trusteeship by a successor trustee.<sup>89</sup>

These consequences do not naturally flow from the trust if it is understood that the trustee has the ownership of the trust assets and merely owes personal obligation to the beneficiary. Independence of the trust property is made possible by the express statutory provisions. Some

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<sup>81</sup> Lusina Ho & Rebeca Lee 'Emerging principles of Asian trust law' in Ho & Lee (n 7) 259, 263-267.

<sup>82</sup> Trust Act § 16.

<sup>83</sup> Ying-Chieh Wu, 'East Asian Trusts at the Crossroads' (2015) 10 National Taiwan U LR 79, 114.

<sup>84</sup> Trust Act § 23(1).

<sup>85</sup> Id § 23(5), applying *mutatis mutandis* Civil Execution Act, Law No 4 of 1979, § 38, and Civil Preservation Act, Law No 91 of 1989, § 45.

<sup>86</sup> Trust Act § 29(1).

<sup>87</sup> Id § 25.

<sup>88</sup> Id §§ 56(1)(iii); 60(4)(5).

<sup>89</sup> Id §§ 56(1)(i); 60(1)(2).

commentators have regarded these consequences as the evidence that the trust creates a separate patrimony.<sup>90</sup> More positivist commentators, though, are contented with the statement that trust is a legal arrangement that confer upon the beneficiary the proprietary remedy by ensuring the independence of ring-fenced assets from the rest of the trustee's personal assets.<sup>91</sup> The debates have been largely academic so long as the trusts were exclusively served by trust banks that are protected from bankruptcy by the government's regulatory supervision. This may change with the rise of the family trust, as varieties of individuals and corporate trustees who begin to serve as trustee and operate outside the auspices of the financial regulators might die or go into bankruptcy at any time.

#### (4) Fiduciary duty

The trustee must follow the trust purposes and administer the trust with the due care of a faithful administrator.<sup>92</sup> In addition, the trustee owes a range of fiduciary duty, including duty loyalty and impartiality, as well as duty to account and earmark.

The duty of care of faithful administrator is a familiar concept found in many private law codifications in civil law jurisdictions. The exact standard of care could vary depending on specific aspects of trust administration or different levels of the trustee's specialization. The drafters of the 2006 Act considered incorporating the prudent investor rule, a body of rules developed in the United States that require trustees to assess a trust's risk tolerance and avoid risks by diversifying the trust investment portfolio.<sup>93</sup> The reformers accepted that trust banks routinely used diversified portfolios in trust investment, but the rule was not adopted for fear that imposing such a duty could cause unintended consequences in small-scale trusts.<sup>94</sup>

The Trust Act introduced the generic duty of loyalty in 2006.<sup>95</sup> The notion of duty of loyalty, first introduced in corporate legislation in 1950, is somewhat unfamiliar to Japanese lawyers. The Supreme Court ruled that it merely elaborated on the traditional duty of care provision in the Civil Code that was applicable to corporate directors.<sup>96</sup> Thus, whether this provision has more than symbolic significance is uncertain. In fact, the Trust Act contains a list

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<sup>90</sup> See Shinomiya (n 76) 67-68; Wu (n 83) 114-18.

<sup>91</sup> See Hiroto Dogauchi, *Trust Law* (Yuhikaku 2017) 17; Hiroto Dogauchi, *Trust Doctrines and the Structure of Private Law* (Yuhikaku 1996) 217-18.

<sup>92</sup> Trust Act § 29(2).

<sup>93</sup> Uniform Prudent Investor Act §§ 2-3 (Uniform Law Commission 1994); Restatement (Third) of Trusts § 90 (American Law Institute 2007).

<sup>94</sup> Masahiro Teramoto, *Commentary on New Trust Act* (rev. ed. 2008) 144; Yasuhiro Kawaguchi, 'Trustee's Duty of Good Faith Administration' (2007) 1261 *J Financial & Commercial L* 56.

<sup>95</sup> Trust Act § 30.

<sup>96</sup> Hideki Kanda & Curtis J. Milhaupt, 'Re-examining Legal Transplants: The Director's Fiduciary Duty in Japanese Corporate Law' (2003) 51 *Am J Comp L* 887, 894.

of prohibited transactions constituting breaches of duty of loyalty in common law jurisdictions. The trustee cannot engage in self-dealing or conflict-of-interest transaction<sup>97</sup> or compete with the trust.<sup>98</sup>

There is a scope for exemption from the duty of loyalty and care. The Trust Act allows reducing the level of duty of care by a specific provision in the trust instrument.<sup>99</sup> However, trust instruments typically do not contain waivers of duty of care because the duty of care provision of the Trust Business Act does not specifically permit such waivers.<sup>100</sup> On the other hand, the Trust Act contains a range of exceptions to conflict of interest transaction. Such transaction can be allowed when the trustee is authorized in the trust instrument or receives approval from the beneficiary upon proper disclosure.<sup>101</sup> In addition, the conflict of interest transaction that is considered reasonably necessary to achieve the purpose of the trust can be allowed either ‘if it is clear that the transaction will not harm the beneficiary’s interests’ or ‘if the transaction is justifiable in light of the relevant circumstances including the impact on the trust property, the purpose and manner of the transaction, the substantial relationship between the trustee and the beneficiary.’<sup>102</sup>

Allowing exceptions to duty of loyalty and mandating a certain level of duty of care makes sense in the commercial context where the trust bank serves as the trustee for numerous trusts such as in collective investment trust. However, the rise of family trust might serve as an opportunity to reconsider. One would reasonably want to exempt family members from onerous duty of care or avoid unnecessary litigation, but there is a good reason to narrowly construe the exception to the duty of loyalty so as to insulate the trustee from temptation to benefit by operating in a conflicted position.

The Trust Act allows the trustee to delegate certain of his trust administration.<sup>103</sup> The trustee can delegate even if the trust instrument does not give specific authorization. This provision was introduced in the 2006 reform, reflecting the specialized nature of modern trust administration.

#### (5) Breach of trusts and remedy

Designing remedies for the breach of trusts is a challenge for lawyers not practicing in common law jurisdictions.<sup>104</sup> Although broad proprietary remedies, such as tracing, are not

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<sup>97</sup> Trust Act § 31.

<sup>98</sup> Id § 32.

<sup>99</sup> Id § 29(2).

<sup>100</sup> Trust Business Act § 28(2).

<sup>101</sup> Trust Act § 31(2)(i)(ii).

<sup>102</sup> Id § 31(2)(iv).

<sup>103</sup> Id § 28.

<sup>104</sup> Lusina Ho, ‘Trusts: The Essentials’, in Lionel Smith ed, *The Worlds of the Trust* (2013) 1,

available in Japan, the Trust Act provide for a remedy that is the equivalent of a constructive trust. If the trustee enters into a transaction with a third party in breach of trust, the beneficiary can rescind the transaction to the extent that the third party transacted in bad faith.<sup>105</sup> Once the transaction is rescinded, the property can be restored following the Civil Code's general provisions and unjust enrichment provisions.<sup>106</sup> This remedy of rescission was introduced as part of 1922 Trust Act to emulate common law constructive trust, although the drafters made technical adjustment to ensure consistency with the underlying civil law principles.<sup>107</sup> Similar provision has been adopted in South Korea, Taiwan, and mainland China.<sup>108</sup>

If as a result of breach of trust the trust asset suffers loss, the court can order the trustee to compensate for the loss or reinstate the lost property.<sup>109</sup> Technically, the Trust Act does not authorize a disgorgement remedy.<sup>110</sup> Nevertheless, under Japanese law, when trustees cause loss as a result of conflicts of interest, competing transactions, or disloyal conduct, the loss is presumed to be equivalent to the trustees' profits.<sup>111</sup> Furthermore, if the trustee enters into a competing transactions, the beneficiary can deem that the transaction were entered into for the trust.<sup>112</sup> Where the trustees cause loss to the trust property after failing to segregate the trust assets, the trustees cannot escape liability for compensation or reinstatement unless they prove that the loss would have occurred even if they had properly earmarked the assets.<sup>113</sup> In this respect, the Japanese reform of 2006 is more conservative than the recent reform in South Korea, Taiwan, or China, where the straightforward disgorgement remedy was introduced.<sup>114</sup> Nevertheless, compared to common law counterparts, these East Asian provisions are limited in scope, and the scarcity of case law in these jurisdictions makes it difficult to make precise comparative assessment.<sup>115</sup>

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<sup>105</sup> Trust Act §§ 27, 31(7).

<sup>106</sup> Civil Code §§ 121, 703–04.

<sup>107</sup> Masayuki Tamaruya, *Transformation of Trust Ideas in Japan: Drafting of the Trust Act 1922*, 88 Rikkyo L Rev 97 (218), 104 (211) (2013).

<sup>108</sup> Japanese Trust Act of 1922 § 31; South Korean Trust Act of 2011 § 75; Taiwanese Trust Act § 18; Chinese Trust Act § 22.

<sup>109</sup> Trust Act § 40(3).

<sup>110</sup> Yoshihisa Nomi, 'Disgorgement of Profits in Japanese Law' in Ewoud Hondius & André Janssen (eds), *Disgorgement of Profits: Gain-Based Remedies throughout the World* (2015) 429, 437-38.

<sup>111</sup> Trust Act § 40(3).

<sup>112</sup> Id § 32(4).

<sup>113</sup> Id § 40(4).

<sup>114</sup> Taiwanese Trust Act §§ 24, 35; South Korean Trust Act § 43(3); Chinese Trust Act § 26.

<sup>115</sup> Ho & Lee (n 81) 272-74.

## (6) Termination and Modification

The trust can be terminated according to the terms of the trust, when the purpose of the trust is achieved or becomes unattainable, or when the office of the trustee is vacant for more than a year.<sup>116</sup> The court can terminate the trust when the circumstances unknown at the time of the creation rendered the termination the best interest of the beneficiaries, or when the continuation of the trust is found to be impermissible from the perspective of the public interest.<sup>117</sup>

The trust can also be terminated by the agreement between the settlor and all the beneficiaries.<sup>118</sup> A similar rule applies to modification of the trust.<sup>119</sup> In this area of trust law where English and American approaches diverge,<sup>120</sup> the 2006 reform of Japanese trust law took a position that is closer to the American position of *Clafin v. Clafin* (1889).<sup>121</sup> The English rule of *Saunders v Vautier* (1841)<sup>122</sup> was not taken, and even if all the beneficiaries are *sui juris* and agree among themselves, they cannot terminate or vary the trust if that is contrary to the purpose of the trust and the settlor do not agree.<sup>123</sup>

This apparent emphasis on the settlor's freedom of disposition that trump the contrary wishes of the beneficiary is consistent the contractarian understanding of the trust and the commercial nature of the trust practices. There is, however, a unique feature of the Japanese trust law, which diverges from the American thinking, but is shared by East Asian civil law jurisdiction. When the settlor and the beneficiaries terminate the trust at a time that is detrimental to the trustee, the trustee can sue them for damages.<sup>124</sup> This is a simple *mutatis mutandis* application of the Civil Code provision on agency contract (*mandate*), where one party who terminates the contract is required to compensate for the other party's loss.<sup>125</sup> It should also be noted that until recently most Japanese trust contracts in commercial context involved a situation where the settlor and the beneficiary were identical, and the concern of dead-hand control rarely arose. As family trusts become common and the trust is increasingly used for succession purposes, the Japanese trust lawyers might need to reconsider the position in light of the emerging pattern of dynastic trust

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<sup>116</sup> Trust Act § 163.

<sup>117</sup> Id §§ 165, 166.

<sup>118</sup> Trust Act § 164(1).

<sup>119</sup> Id § 149(3)(i)

<sup>120</sup> Robert H Sitkoff 'Trust and Estates: Implementing Freedom of Disposition' (2014) 58 St Louis LR 643; Joshua Getzler, 'Transplantation and Mutation in Anglo-American Trust Law' (2009) 10 Theoretical Inquiries in Law 355; Lawrence M. Friedman, 'The Dynastic Trust' (1964) 73 Yale LJ 547; Austin Wakeman Scott, 'Fifty Years of Trusts' (1937) 50 Harv LR 60, 71.

<sup>121</sup> 20 N.E. 454 (Mass. 1889); Restatement (Third) of Trust § 65.

<sup>122</sup> 4 Beav. 115 (1841); Variation of Trusts Act 1958 c 62 (UK).

<sup>123</sup> Trust Act §§ 164(1), 165, 149(3)(ii)

<sup>124</sup> Id § 164(4).

<sup>125</sup> The 1922 Trust Act expressly provided for *mutatis mutandis* application of Civil Code § 651(2). See also South Korean Trust Act 2011 § 99(3); Taiwanese Trust Act § 63.

and dead-hand control.

#### (7) Spendthrift or Protective Trust

Despite the strong control that the settlor enjoys in the context of termination and modification of the trust, Japanese Trust Act has not given the settlor power to create what is known in the U.S. as spendthrift trust, in which the beneficiary cannot voluntarily alienate his or her interest in the trust.<sup>126</sup> Historically, the U.S. Supreme Court case of *Nichols v. Eaton* (1875)<sup>127</sup> that sanctioned spendthrift trust was a precursor to the decision in *Clafin* that departed from the English rule of *Saunders v Vautier*. Nevertheless, the Japanese trust law has not followed the historical and the logical connection in the U.S..

There are both policy reason and jurisprudential reason for the Japanese departure from the American jurisprudence. The policy reason was that the drafters of the 1922 Trust Act were keen to ensure that the trust could not be used to shield the asset from the reach of beneficiary's creditors<sup>128</sup>. Under the 1922 Act, the beneficiary's creditor could apply to the court and request termination of the trust if the beneficiary cannot pay his debt without liquidating his beneficial interests.<sup>129</sup> Although this provision was removed after the 2006 reform, it did not signal a policy choice to allow spendthrift trusts. It was rather in response to the call to ensure the stability of trust structure in commercial contexts during the 1990s. The old provision had been criticized by the securitization industry that it could allow the beneficiary's creditor to terminate the trust under circumstances that cannot be controlled by either settlor or trustee.<sup>130</sup> The current Trust Act provides for the termination by agreement between the settlor and the beneficiary,<sup>131</sup> and at the same time significantly narrows the scope of termination upon court approval.<sup>132</sup>

The jurisprudential reason was that for the purpose of regulating the assignment of beneficial interest the Japanese Trust Act relied on the analogy with the assignment of chose in action.<sup>133</sup> According to Section 466(2) of the Civil Code, the creditor and the debtor can agree that the chose in action be unalienable, but under established case law, such agreement cannot preclude the attachment by the creditor's creditor. The Supreme Court held that private parties

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<sup>126</sup> Restatement (Third) of Trust § 58.

<sup>127</sup> 91 U.S. 716 (1875).

<sup>128</sup> Akira Yamada, *On the Legislative Process of the Trust Laws* (1981) 124-25.

<sup>129</sup> Trust Act of 1922 § 58.

<sup>130</sup> See Standard & Poor's, *Japanese Structured Finance: The Bankruptcy Remoteness of Trusts* (March 7, 2008), available at <[http://www.standardandpoors.com/ja\\_JP/delegate/getPDF;jsessionid=74aneWrYkYY50WRHVfYREQuViRa1MRXOgIx7uPeHMEzuoF\\_N7vQ6!-1077768946?articleId=1773378&type=COMMENTS&subType=CRITERIA](http://www.standardandpoors.com/ja_JP/delegate/getPDF;jsessionid=74aneWrYkYY50WRHVfYREQuViRa1MRXOgIx7uPeHMEzuoF_N7vQ6!-1077768946?articleId=1773378&type=COMMENTS&subType=CRITERIA)> .

<sup>131</sup> Trust Act § 164(1).

<sup>132</sup> Id 165(1). See n 117 and accompanying text.

<sup>133</sup> Compare Trust Act §§ 93-95, and Civil Code §§ 466-468.

cannot render any chose in action exempt from judicial attachment, for otherwise general creditors could be unduly harmed by being deprived of the assets to which they could otherwise have recourse.<sup>134</sup> In a similar logic, Japanese trust lawyers have reasoned that a private agreement purporting to insulate beneficial interests from judicial attachment would be counter to the public policy and thus unenforceable.<sup>135</sup>

Some commentators have sought to exploit the limited scope of exception to the Japanese policy against inalienability. The current Japanese Trust Act recognizes such exception where the alienation is contrary to its inherent nature of the beneficial interest.<sup>136</sup> Although the scope of this abstract provision is unclear, one possible example is the qualified trust for support of a person with disability. Such a trust qualifies for gift tax exemption if it specifically provides that the relevant beneficiary right cannot be transferred or pledged.<sup>137</sup> Another possible example is the qualified retirement pension trusts, which enjoy corporate tax exemption as serving the welfare of a particular beneficiary.<sup>138</sup>

It is not clear whether a similar argument can be made for other trusts that do not qualify for tax exemption but are similarly intended to further a particular beneficiary's personal wellbeing. The views of commentators vary. It is entirely possible to argue that extension of such exemption cannot be allowed because of the public policy of prohibiting private parties to render any assets immune from the creditors' reach. Note that only a limited category of chose in action, such as certain government benefits, wages and retirement benefits, which is intended to support the debtor's basic living, are exempt from judicial execution.<sup>139</sup> Yet some commentators argue that broader protection of beneficial interest from the beneficiary's creditors might be warranted for a trust that is created for the sole purpose of protecting a particular beneficiary (and not the settlor himself).<sup>140</sup> According to this theory, a trust can be created to shield attachment of the beneficial interest to the extent that it actually supports the intended beneficiary's welfare, but not beyond such extent. No case has been reported, but if that is allowed, it would in effect authorize a limited scope of spendthrift protection.<sup>141</sup>

Here again, the rise of family trust might bring about attempts to test the possibility of creating inalienable beneficial interests. Another possibility that have not been explored is the creation of protective trust, a kind of trust sanctioned in England and other common law

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<sup>134</sup> [party name unknown], 24(4) Minshu 240 (Supreme Court Apr. 10, 1970).

<sup>135</sup> Shinomiya (n 76), at 330.

<sup>136</sup> Trust Act § 93(1). This parallels the Civil Code § 466(1) on alienability of chose in action.

<sup>137</sup> Inheritance Tax Act § 21-4(2); Inheritance Tax Act Enforcement Order § 4-12.

<sup>138</sup> Makoto Arai, *The Law of Trusts in Japan*, 335 (3rd edn 2008).

<sup>139</sup> Civil Execution Act, Law No 4 of 1979, § 152.

<sup>140</sup> Arai (n 138), at 335.

<sup>141</sup> See Adam S. Hofri-Winogradow, 'The Demand for Fiduciary Services: Evidence from the Market in Private Donative Trusts' (2017) 68 *Hastings LJ* 931.

jurisdiction that practically achieve the same result as the American spendthrift trust.<sup>142</sup> The protective trust ceases to exist typically in the event of attempted attachment of the beneficial interest by a beneficiary's creditor, and automatically convert itself into a discretionary trust in which the beneficiary has no entitlement to the assets.<sup>143</sup>

#### IV. International Trust Practices

Despite the scale of the commercial trust operation, the Japanese trust practices appears to have a very limited presence in the international sphere.<sup>144</sup> That is particularly so when compared to offshore trust services offered in international financial centres in Hong Kong and Singapore. Nevertheless, there is a sign that Japanese property owners are moving their assets across national borders in increasingly large amount and frequency. The Japanese court is beginning to face a number of trust and succession cases that arise in cross-border settings.

##### (1) Recognition and Enforcement of International Trust

Japan has not signed the Hague Trust Convention. When the statutory choice-of-law rules were overhauled in 2006,<sup>145</sup> a proposal was made to introduce specific provisions applicable to trust law. However, this was rejected as premature since trust law was being reformed and the uniform treatment of commercial trusts and family trusts needed further consideration based on case law development.<sup>146</sup>

As of the time of writing, no reported case has dealt with the recognition or enforcement of foreign trusts. Therefore, there is much uncertainty in this area. However, a recent case involving a joint bank account in Hawaii elucidates how the Japanese court might treat trusts and other forms of will-substitutes created overseas.<sup>147</sup> The case involved a will whereby the deceased left his wife 40% of his financial assets and the entire real estate, and the remaining 60% of the financial assets to his son with the previous wife. The wife was designated executor, and when her husband died, she divided the estate with her stepson amicably according to the will. Two years later, however, a joint account at the Bank of Hawaii was found under the name of the decedent and his wife, with funds worth 38,957,000 yen deposited. The son sued his stepmother to assert his 60% stake in the joint account.

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<sup>142</sup> *Brandon v Robinson* (1811) 18 Ves. Jr. 429, 34 Eng. Rep. 379 (Ch).

<sup>143</sup> See Trustee Act 1925, s33 in England and Wales.

<sup>144</sup> The following section is taken from Masayuki Tamaruya, 'Japanese wealth management and the transformation of the law of trusts and succession' (2019) 33 TLI 147.

<sup>145</sup> General Rules for Application of Laws Act, Law No 78 of 2006, replacing Law Rules Act, Law No 10 of 1898.

<sup>146</sup> Kunio Koide, *Commentaries on General Rules for Application of Laws Act* (revised edn, Shoji-Homu 2014) 410-18.

<sup>147</sup> 1415 Hanrei Times 283 (Tokyo District Court, 8 July 2014).

The joint account is unfamiliar to the Japanese. Japanese banks do not offer joint accounts, and Japanese property law does not recognise joint tenancy with survivorship. The court declared that the deceased's national law (in this case, Japanese law) applied when determining the types of property that could be included in the decedent's estate. However, whether a particular property or right becomes the object of inheritance is determined by the law of the place chosen in the dispositive juridical act, or, in the absence of such choice, by the law of the place with which the juridical act is most closely connected at the time of the act. Whether the bank account was subject to inheritance depended on the latter factor, and so the applicable law was the law of Hawaii, the governing law of the bank account. Under Hawaiian law, which largely follows the Uniform Probate Code, when one of the parties to the joint account dies, the funds held automatically shifts to the surviving party without going through probate.<sup>148</sup> The court thus concluded that since the fund was not subject to probate under Hawaiian law, it did not constitute the deceased's estate in this case.

One might be tempted to deduce from this case that the Japanese court is likely to regard trusts created overseas as an effective will-substitute, bringing trust property outside the scope of succession law. However, caution is warranted. In this case, the issue of forced heirship was not brought up by either party, and it appears that the deceased did not have any intention to evade any of the restrictions imposed by the law of succession. In fact, the court specifically cautioned that issues related to forced heirship are governed by the deceased's national law, leaving the possibility that disgruntled heirs could obtain assets disposed of by any will-substitute if their forced shares are involved.<sup>149</sup>

## (2) Prevention of Abuse

As already seen, the Japanese law and practice of trust is relatively transparent. Registrable trusts must be registered;<sup>150</sup> non-charitable purpose trust has never been created;<sup>151</sup> and the scope of spendthrift and protective trust is limited.<sup>152</sup> When the Panama Papers attracted world-wide attention in 2016, it revealed a number of Japanese nationals and entities,<sup>153</sup> but Japan was absent from the list of major countries where money was hidden, where intermediaries operated from, or where hidden owners resided.<sup>154</sup>

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<sup>148</sup> Hawaii Revised Statutes Annotated § 560:6-104(a). See also Uniform Probate Code § 6-212.

<sup>149</sup> This position is consistent with the Hague Trust Convention, Article 15c.

<sup>150</sup> See note 60 and accompanying text.

<sup>151</sup> See notes 67-68 and accompanying text.

<sup>152</sup> See notes 126-143 and accompanying text.

<sup>153</sup> 'How Have Japanese Business Leaders Responded to the Panama Papers?' Weekly Toyo Keizai (June 1, 2016); Kirk Spitzer, 'For Japan, Panama Papers are tool to skewer China' USA Today (April 8, 2016).

<sup>154</sup> See eg Luke Harding, 'What are the Panama Papers?: A guide to history's biggest data leak'

Nevertheless, as international attention on the shady aspect of wealth management intensifies, the Japanese government and wealth management practitioners are struggling to respond. The Financial Action Task Force evaluated the Japanese system of preventing criminal abuse of the financial system. Its report published in 2008 stated that Japan failed to provide sufficient measures to curtail money laundering and combat terrorism financing. More specifically, the Task Force cited the lack of mechanisms or measures to ensure transparency concerning beneficial ownership and structure of control of trusts and other legal arrangements as part of serious deficiencies in customer due diligence towards obligations.<sup>155</sup> The timing was unfortunate, because the audit was conducted just after the 2006 revision of the Trust Act, which provided the practitioners with little time to digest the reform.

The Japanese government was disgraced again. In 2014, the Task Force specifically called on Japan to enact adequate anti-money laundering and counter-terrorist financing legislation.<sup>156</sup> Once again, the timing may have been unfortunate. As already seen, Japanese trust practices underwent further transformation since 2011. More importantly, an increasing number of non-bank trustees began to operate largely underneath the radar of the financial regulators that had overseen the industry. As of the time of writing, another on-site visit to Japan is scheduled in October to November 2019 by the Task Force for the mutual evaluation, and the plenary discussion is scheduled for June 2020.

## Conclusion

Japanese trust law is an amalgam of multiple legal traditions: the civil law tradition forming the basis of private law, the English trust law introduced through codification in California and India, and the commercial practices introduced from the U.S. mortgage trust practices. In part because of the common civil law background and also in part because of the historical past of colonialization, Japanese trust law and practices have influenced some of the East Asian jurisdictions.

Despite such rich history of comparative endeavour, the Japanese trust practices were mostly concentrated on commercial trust managed by trust banks, and the rise of traditional common law trust was seen only within the past decade. The Japanese trust practitioners and the courts are facing some of the basic trust questions only within the past five or six years. Another

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Guardian (5 Apr 2016), available at < <https://www.theguardian.com/news/2016/apr/03/what-you-need-to-know-about-the-panama-papers> >.

<sup>155</sup> FATF/GAFI Financial Action Task Force, *Third Mutual Evaluation Report: Anti-Money Laundering and Combating the Financing of Terrorism: Japan* (17 October 2008), Recommendation 33, at 189; Recommendation 34, at 190.

<sup>156</sup> FATF calls on Japan to enact adequate anti-money laundering and counter-terrorist financing legislation (2014), available at < <http://www.fatf-gafi.org/documents/documents/japan-aml-cft-deficiencies.html> >.

irony is that, again despite its comparative history, Japan has so far struggled to keep up with the international development on various issues that touch on trust law.

At the same time, the Japanese struggle can be situated in a broader Asia-Pacific or global perspective. Today, in both common law and civil law jurisdictions, trusts are used in both family and commercial settings. It appears that many common law jurisdictions are increasingly interested in commercial aspect of trust practices, while non-common law jurisdictions are warming up to exploit the trust's potential for wealth management and succession planning. In the meanwhile, the world is weighing the merit of the trust against its susceptibility to abuse within the global movement of wealth and capital. The struggle might be inevitable, as Japanese trust law continues to evolve along with the transnational development in the law and practice of trusts.