Shanghai
19F, ONE LUJIAZUI
68 Yin Cheng Road Middle
Shanghai 200120 P.R.China
Tel: (86 21) 3135 8666
Fax:(86 21) 3135 8600

Beijing
Units 902-903
Winland International Finance Centre
No.7 Finance Street, Xicheng District
Beijing 100033 P.R.China
Tel: (86 10) 6655 5050
Fax:(86 10) 6655 5060

上海
上海市银城中路68号
时代金融中心19楼
邮政编码: 200120
电话: (86 21) 3135 8666
传真: (86 21) 3135 8600
www.llinkslaw.com

北京
北京市西城区金融大街7号
英蓝国际金融中心9楼02-03单元
邮政编码: 100033
电话: (86 10) 6655 5050
传真: (86 10) 6655 5060
master@llinkslaw.com

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Brief Analysis of the Legal Feasibility of Using "Income Rights" as Trust Property

By Tommy Xia, Susan Sun and Jessie Tang

A type of trust products created by using the "income right" as trust property has emerged in the market. The authors will discuss the legal nature of the "income right" and the legal feasibility of using it as trust property when creating trust products.

Analysis on the Legal Nature of "Income Right"

Two types of trust products are created by turning the "income right" into trust property: equity income right-based trust products and special asset income right-based trust products.

Firstly, regardless of whether the right of income from equity or right of income from special asset income is involved, the said right does not amount to ownership right. Under the Real Right Law, ownership involves the right to possess, utilize, seek profit from and dispose of a realty or chattel[1]. The right to seek profit from a realty or chattel is an inherent right in the ownership, but it does not mean that this right may be assigned separately.

Secondly, under the Company Law,[2] the right to benefit from assets of a company by its shareholders is considered part of shareholders' rights. If the shareholder's rights are divided into self-profit rights and common-profit rights, based on the equity and purpose of an equity exercise, the right to benefit from assets by shareholders should fall under the self-profit right. Due to the identity attribute of equity, it is still disputed whether the right of shareholders to benefit from assets can be assigned separately.[3] Meanwhile, under the Company Law, the shareholders recorded in the roster of shareholders may claim and exercise the rights of shareholders on the strength of the roster of shareholders.[4] Therefore, the equity income right in the trust product is not a right of shareholders to benefit from assets as a self-profit right in the common sense.

To sum up, we believe that the income right mentioned here can be seen as a future creditor's right. Some scholars believe that a future creditor's right should include: (1) the creditor's right with a starting term which

如果您需要本出版物的中文本，请与下列人员联系：

郭建良: (86 21) 3135 8756
Publication@llinkslaw.com

If you would like other Llinks publications, please contact:

Roy Guo: (86 21) 3135 8756
Publication@llinkslaw.com

Llinks Law Offices
www.llinkslaw.com

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has not yet occurred; (2) the creditor’s right with termination conditions which have not yet occurred, that is, such a creditor’s right has been established but not yet taken effect and it will become a real creditor’s right only when specific facts occur; (3) the creditor’s right which has not yet occurred due to lack of certain facts but the basic legal relationship has been established; (4) the creditor’s right which has not yet occurred with only factual relationship but any legal relationship. In the narrow sense, the future creditor’s right refers only to the circumstance in Item (4), which is called a pure future creditor’s right. In the income right-based trust legal relationship, the principal entrusts his income right to the trustee (i.e. the trust company) who will manage or dispose of such income right in his own name according to the principal’s intention and for the interest or special purpose of the beneficiary. We believe that when the trust relationship is established, the income right is more like an unreal creditor’s right, i.e. a creditor’s right in the nature of a future creditor’s right.

From another point of view, as a trust property is transferable by its nature, it should be able to be transferred and entrusted by the principal to the trustee as a property right, i.e. all the properties that are transferable are likely to become trust properties. Generally, the scope of trust properties includes chattels, real properties, real right, creditor’s right, intellectual property right, stock, creditor’s right, etc. In this case, the legal nature of the income right is closer to a creditor’s right.

Legal Feasibility of “Income Right” as Trust Property

The trust property of the principal, by its nature, is characterized by its activity, certainty and transferability.

- Activity

  The income right is an active property. An active property is a property or property right that can actually increase the property rights or prospect interests of the right holder. Although the return on equity varies with a company’s business decisions and profit status, the shareholders will either obtain income or obtain no income, without being liable for the holding of their shares.

- Transferability

  The issue of transferability has been mentioned above. As the income right is a property right, the right holder may realize the property value through a transfer of such property. Currently, there is no explicit provision concerning future creditor’s right or the transfer of future creditor’s right under the Chinese laws and legislations, but it can be seen from the system of mortgage of maximum amount in the Guarantee Law that legislators’ attitude to the future creditor’s right is positive.[5]

- Certainty

  With regard to the traditional trust legal theory, the future creditor’s right might not necessarily occur in the future, or the amount of money is unlikely to be determined even if it occurs, thus it is generally accepted that the future creditor’s right fails to fulfill the essential condition for the certainty of trust properties.[6]

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We believe that although the income right is merely a future creditor's right or unreal creditor's right in creating a trust, if relevant factors for the occurrence of the future creditor's right and possibility of realizing such right can be clarified in the trust document, including (but not limited to) relevant asset, debtor, type of contract, scope and method of collection relating to the future creditor's right and so on, it can be deemed that the trust property is determined in practice.

Advice and Expectations

In view of the accelerating development of the financial market, it seems rather conservative to deny the feasibility of the future creditor's right as a trust property due to its uncertainty in general. However, to maintain the security of market transactions and protect the rights and interests of third parties, it seems a complete set of supporting systems is necessary. Currently, China's income right-based trust products are those with the income right as the subject matter of a trust investment. We believe that, with the continuous development of the trust industry, more trust products with the income right as a trust property will emerge in the market. China should refer to the operating modes of foreign asset securitization to develop its asset securitization business so that the creditor's right transferred by sponsors to a special purpose trust (SPT) may include both a real creditor's right and a future creditor's right. It is suggested that while improving relevant trust laws and provisions, legislators should consider formulating more specific legislation, establishing a complete set of supporting systems, providing more specific provisions and guidance with respect to possible problems encountered in practice (such as creating a trust with a future creditor's right).

1. Under Article 39 of the Real Right Law of the People's Republic of China, the owner of a realty or chattel is entitled to possess, utilize, seek profit from and dispose of the realty or chattel in accordance with the law.
2. Under Article 4 of the Company Law of the People's Republic of China, the shareholders of a company shall enjoy such rights as benefiting from assets of the company, making major decisions and selecting management personnel in accordance with the law.
3. Xi Xiaoming, Disputes over Equity Transfer, Law Press, October 2007, P14.
4. See Article 33 of the Company Law of the People's Republic of China.
5. Under Article 59 of the Guarantee Law of the People's Republic of China, a mortgage of maximum amount as used in this Law means that the mortgaged property shall be used to secure the creditor's claims which occur successively during a given period of time and to the extent of the total amount of the claims, as agreed upon between a mortgagor and a mortgagee.
6. Under Article 7 of the Trust Law of the People's Republic of China, to create a trust, there must be a definite property under the trust.

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Contact Details

If you would like to know more information about the subjects covered in this publication, please feel free to contact the following people or your usual Llinks contact.

Shanghai	Beijing
Christophe Han Tel: (86 21) 3135 8778 (86 10) 6655 5020 Christophe.Han@llinkslaw.com	**James Weng** Tel: (86 10) 6655 5050 - 1028 James.Weng@llinkslaw.com
Charles Qin Tel: (86 21) 3135 8668 (86 10) 6655 5020 Charles.Qin@llinkslaw.com	
Sandra Lu Tel: (86 21) 3135 8776 (86 10) 6655 5020 Sandra.Lu@llinkslaw.com	

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