

Private Client Business

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For or against the registration of trusts - why it matters: balancing regulatory concerns and the right to privacy

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Legislation: Directive 2005/60 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing [2005] OJ L309/15 art.3

**P.C.B. 137 The EU Parliament has voted to introduce a trust registry as part of new anti-money laundering provisions. This article explains why the registry idea misses the point and why it has wider implications for EU citizens, whether or not they use trusts.*

"Know your client" rules — a necessary evil

For decades, the European Union has been at the forefront of fighting money laundering. Ordinary citizens may not be aware of the exact content of the rules, but there is no doubt that everyone's life is affected by them. Anyone who has opened a bank account or retained a solicitor or accountant in the last 10 years will be able to tell you of the need to produce the original or certified copy of a passport and a proof of address. These so-called "know your client rules" are generally perceived as mild inconveniences that are needed to protect the integrity of the financial system against fraudsters and money launderers. In general, they are seen as necessary and proportional to the objective they are trying to achieve. So, why would the proposed introduction of trust registers be any different?

Trusts — perceived as suspicious by nature

Civil law countries do not have trusts in their legal systems, and therefore have no opportunity of seeing how useful they are in everyday life. Thus, when Switzerland was debating the formal recognition of trusts (the trust concept is alien to continental European laws), an early version of the explanatory memorandum prepared by the government contained the following statement:

"[There are] possible public policy concerns: in Switzerland, the trust concept is often met with scepticism. It is often perceived as a means to hide the real ownership position and as a tool for tax evasion, money laundering and the violation of succession law provisions."¹

And in France, the Government recently tabled a draft law combating "tax evasion and substantial economic and financial criminality". The press release explained that: **P.C.B. 138*

"The new law will deal with tax fraud committed by an organised group, such as the one which relies on bank accounts or foreign entities such as trusts and foundations."²

These comments ignore the fact that any bank and any professional who comes into contact with a trust is subject to strict statutory obligations to identify the "beneficial owners" of the trust, i.e. the settlor, beneficiaries and any person with power to control the trust assets, such as protectors—see art.3(6) of the Third Money Laundering Directive:

"For the purposes of this Directive (...) 'beneficial owner' means the natural persons who ultimately owns or controls the customer and/or the natural person on whose behalf a transaction or activity is being conducted.

The beneficial owner shall at least include

- (a) "in the case of corporate entities (...)

- (b) in the case of legal entities, such as foundations, and legal arrangements, such as trusts, which administer and distribute funds:
- (i) where the future beneficiaries have already been determined, the natural person(s) who is the beneficiary of 25 % or more of the property of a legal arrangement or entity;
 - (ii) where the individuals that benefit from the legal arrangement or entity have yet to be determined, the class of persons in whose main interest the legal arrangement or entity is set up or operates;
 - (iii) the natural person(s) who exercises control over 25 % or more of the property of a legal arrangement or entity."

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This provision has been transposed into the domestic laws of the EU Member States (as required by EU law) and a brief review of the national rules (e.g. those in the United Kingdom,⁴ Ireland⁵ and Italy)⁶ show that the content of art.3(6) is now part of the various countries' law.

Other financial centres (such as Switzerland) have introduced similar rules.⁷

Therefore, it must be concluded that statements such as the ones made by the Swiss and French Governments reflect ignorance of the trust mechanism and are based on prejudices rather than a proper analysis of the interaction between trust law and existing EU money laundering rules.

Trusts — not just the preserve of the rich

Another wide-spread perception is that trusts are the preserve of the rich, who present a higher risk to governments in terms of tax avoidance and tax evasion. This perception is particularly felt in countries that do not use the trust concept. The reality could not be more different. In England and Wales, trusts are widespread and pervade every aspect of day-to-day life. As a respected French author without any axe to **P.C.B. 139* grind once noticed: "The trust is the guardian angel of the Anglo-Saxon, who accompanies him everywhere, impassively, from the cradle to the grave."⁸

This often quoted statement reflects the fact that, in England, trusts are often created by operation of law in very mundane circumstances. Examples include:

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Co-ownership of land.

Any property owned by two or more persons is, as a matter of law, held by them as trustees, mostly to ensure that third parties acquiring land in good faith are protected.

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Administration of deceaseds' estates.

Under the law of most continental European countries, the assets and liabilities of a deceased vest directly in the heirs (principle of "universality of succession"). This may have some undesired results, particularly where the deceased was insolvent. By contrast, under English law the estate is temporarily "parked" with a so-called "personal representative" (executor or administrator) whose job is to liquidate the estate and pass on any surplus to the beneficiaries. As a fiduciary owner, a personal representative is subject to the duties that apply to trustees.

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Protection of children during minority.

Under the law of most continental European countries, a child owns his own assets, although they are administered by his/her parents or legal guardians who are subject to statutory duties of care. In England, the position is slightly different, in that the law provides that a child may not hold a legal estate in land⁹ and whilst a child may own chattels, in practice any valuable assets (e.g. bank accounts) are generally owned by his/her parents or legal guardian as trustee for the child. Thus, the net result is the same (child's protection), but in England this objective is generally achieved through the use of trusts.

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Protection of vulnerable, handicapped and prodigal persons.

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Pro-rata payment of creditors on bankruptcy.

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Retirement pension schemes.

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Employee share ownership plans.

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Collective investments by small savers, etc.

Against this backdrop, the introduction of national registers will have far-reaching consequences in terms of the publicity of common citizen's personal affairs. Unsurprisingly, in an open letter dated November 14, 2013 to the President of the EU Council, the British Prime Minister noted as follows:

"I know some want Europe to go even further to prevent the abuse of trusts and related private legal arrangements. It is clearly important to recognise the important differences between companies and trusts. This means that the solution for addressing the potential misuse of companies—such as central public registries—may well not be appropriate generally. Nonetheless, as Europe leads from the front on company beneficial ownership, I look forward to looking properly at the arguments around trusts and other legal arrangements in order to determine what further action we might take".

Unfortunately, due to the current relationship that exists between the UK Government and the European Union, there is a danger that Mr Cameron's comments will fall on deaf ears—or will be dealt with as a political attempt to derail an EU initiative. From the perspective of a private client lawyer who works with **P.C.B. 140* individuals and families to plan their affairs, this would be a yet another unnecessary bureaucratic restriction on individual freedom.

What is this really all about?

The existing money laundering rules put onerous duties on anyone in the regulated sector to identify the beneficial owners of any trust relationship. To the extent that someone was attempting to use a trust for unsavoury reasons, the existing "know your client" and other anti-money laundering measures should keep the relevant trust away from the financial system. In addition, the financial intermediary would be under a duty to make a disclosure to the relevant authorities—or face up to five years imprisonment.¹⁰

National registration of trusts is neither a necessary, nor proportionate, measure in the fight against money laundering. Instead, it exemplifies an institutionalised distrust, which is based on ignorance, in continental Europe, for a legal mechanism created by the common law. There may also be something in the way of a culture clash between two systems of law following the credit crunch of 2007/2008, which laid bare the weakness of the Anglo-Saxon model of capitalism (even in the eyes of the Anglo-Saxon financial press)¹¹ and provoked a backlash from continental Europe in a number of areas, including whether or not bankers' pay should be capped.

It is perhaps unsurprising that in 2009 France introduced draconian tax rules which effectively subject any trust with French resident beneficiaries to wealth tax and succession taxes by reference to the whole of the trust fund, irrespective of whether the beneficiaries in question have a vested interest or are mere discretionary beneficiaries (so that they may never benefit from the trust). Thus, under the new French rules a trust worth €10 million with, say, 20 discretionary beneficiaries—of which one happens to be resident in France—is now subject to French tax on the whole €10 million,¹² even though none of them ever receives a penny.

Edward Snowden and intrusion into privacy

There is, however, something perhaps even more worrying than the idea of a legal concept being caught up in the eye of a storm between two diverging economic models, or the introduction of rules based on ignorance (if that is possible).

The disclosures made by Edward Snowden have shown the insatiable appetite of governments for intruding into the private sphere of their citizens. Even leaving aside espionage, the international community is moving towards the idea of automatic exchange of information between tax authorities of various countries.¹³

The dangers of indiscriminate dissemination of information without judicial supervision was highlighted in a BBC documentary,¹⁴ in which the Panorama journalists investigated the mysterious disappearance in Dubai of a British businessman. According to the investigative journalists, the British authorities handed over thousands of pages of his confidential documents to the Iranian authorities without informing the British businessman involved and ignoring the warnings that their actions posed a risk to his life (the businessman was kidnapped and is now feared dead). ***P.C.B. 141**

Options

For individuals who still wish to maintain privacy regarding their assets and planning, the registries will raise very real concerns. Whilst the implementation of the EU directive is yet to be clarified—and each country will have some degree of latitude as to how they put it into law—individuals may want to consider alternative structures that offer the similar levels of privacy as trusts have historically provided. These could include:

- Family Limited Partnerships;
- LLPs;
- Life insurance solutions; and

- The use of non-EU jurisdictions.

Conclusions

At best, the introduction of public registers of trusts throughout the EU displays an ignorance of, and visceral antipathy towards, a legal instrument that is only known in the domestic law of four of the 28 countries that make up the EU.

It is interesting to note that no-one is proposing introducing a public register of life insurance contracts. Like trusts, life insurance contracts are private arrangements that are widely used for succession planning purposes. They are very popular in continental Europe. The EU is targeting trusts because civil law countries do not use them, do not understand them, and therefore think the worst of them. But suppose that the EU proposed to insist on a register of life assurance contracts, with huge quantities of personal information concerning the parties involved and, in particular, who was to benefit from the policies.

From a legal perspective, the proposed rules are neither necessary, nor proportional. Indeed, they miss the point, as the way to fight money laundering consists in imposing verification and notification duties on anyone who works in a regulated sector, regardless of whether a legal instrument is registered or not.

Worst of all, the proposed rules show a keen disregard, by European governments, of their citizens' right to privacy at a time when they seem to be genuinely dismayed at the intrusion tactics of governmental spying agencies.

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- 1. Explanatory memorandum dated September 16, 2004, para.1.4.5.
- 2. See <http://www.gouvernement.fr/print/gouvernement/lutte-contre-la-fraude-fiscale-et-la-grande-delinquance-economique-et-financiere>.
- 3. Directive 2005/60/EC, available at: <http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2005:309:0015:0036:en:PDF>.
- 4. In the UK, the provisions of the Third Money Laundering Directive have been implemented primarily through secondary legislation issued by the Treasury (The Money Laundering Regulations 2007), available at: <http://www.legislation.gov.uk/ukSI/2007/2157/regulation/3/made>.
- 5. In Ireland, the Third Money Laundering Directive was implemented into domestic law by The Criminal Justice (Money Laundering and Terrorist Financing) Act 2010 (as amended by the Criminal Justice Act 2013) which first came into force on July 15, 2010, available at: <http://www.irishstatutebook.ie/pdf/2010/en.act.2010.0006.pdf> [Accessed April 3, 2014].
- 6. Italy was the first continental European country to formally recognise trusts. As far the Third Money Laundering Directive is concerned, this was transposed into domestic law by Law Decree 21 November 2007, fn.231.
- 7. Article 43 of the Code of Due Diligence issued by the Swiss Bankers Association provides as follows: "in the case of associations of individuals or asset-holding entities and foundations where no specific individuals or entities are the beneficial owners (e.g. discretionary trusts), the contracting partner must be required to provide a written declaration that this is the case, rather than identifying the beneficial owner. The declaration must also contain information about the actual founders (and not those acting in a fiduciary capacity) and, if identifiable, those individuals or entities that are empowered to issue instructions to the contracting partner or its corporate bodies, as well as those persons or entities

that are potential beneficiaries (by category, e.g. 'members of the founder's family'). Any curators, protectors, etc. must also be listed in this declaration."

8. *Pierre Lepaulle, Traits théorique et pratique des trusts an droit interne, en droit fiscal et en droit international, (Paris: Rousseau & Cie, 1932), p.113.*
9. Law of Property Act 1925 ss.1(6) and 19.
10. See ss.330 and 334 of the Proceeds of Crimes Act 2002.
11. By way of illustration, on *February 19, 2009 Forbes.com ran an article entitled Laissez faire Capitalism has Failed* in which the columnist declared that "the financial crisis lays bare the weakness of the Anglo-Saxon model", a sentiment that was also at the core of an article published on *September 23, 2008 in The Telegraph ("Financial Crisis: Capitalism is not dead yet, but Anglo-Saxon finance is looking weak")*.
12. Article 14 of the "la loi de finances rectificative 2011" N°2011-900 dated July 29, 2011 introduced a number of new provisions into the French Tax Code.
13. See "*The new Common Reporting Standard for automatic exchange of information in tax matters*" OECD, February 13, 2014.
14. "*Kidnapped: Betrayed by Britain*" Panorama, February 28, 2014.

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