

STEP's Response to HM Treasury's Consultation on the Transposition of the Fifth Money Laundering Directive published on 15 April 2019

About us

STEP is the worldwide professional association for those advising families across generations. We help people understand the issues families face in this area and promote best practice, professional integrity and education to our members.

Today we have over 20,000 members across 95 countries, with over 7,000 members in the UK. Our membership is drawn from a range of professions, including lawyers, accountants and other specialists. Our members help families plan for their futures: from drafting a will or advising family businesses, to helping international families and protecting vulnerable family members.

STEP supports the principle of effective measures to combat money laundering and we have worked constructively with national governments and others to develop practical and effective mechanisms to combat money laundering. We believe that the enforcement of rigorous standards on trust and company service providers has a key role to play in combatting money laundering. However it is important that measures to combat money laundering respect families' basic rights to legitimate confidentiality in their financial affairs and ensure that sensitive financial information is not vulnerable to abuse.

Given the nature of the work carried out by our members, we are responding only in relation to the issues raised in chapter 9 dealing with trust registration requirements.

STEP welcomes the opportunity to respond to this consultation.

Executive summary

1. STEP recognises the need to implement the 5MLD but this must be done in a way that is necessary and proportionate. The public interest must be balanced with the fundamental rights of individuals.

2. Express trusts for the purposes of Article 31 should be defined using a definition based on s43 IHTA 1984 (but excluding certain foreign arrangements). Co-ownership arrangements, nominee (bare trust) arrangements and commercial trusts should not be treated as express trusts.
3. It would be disproportionate to require the registration of trusts of life insurance policies, trusts holding pension or death benefits and pilot trusts or trusts with only nominal value until these trusts actually receive funds. In certain cases, it may be appropriate to have a de minimis trust fund value below which no registration is required.
4. Article 31 only applies to trusts which are administered in the UK and given that this is a key factor it will be important to have a clear definition of what this means. A trust should not be treated as administered in a jurisdiction simply because the trustees have engaged a third party service provider (such as an investment manager, lawyer or accountant) in that jurisdiction.
5. Of the trusts administered in the UK, only the following would need to be registered: trusts where the trustees are established in the UK or reside in the UK; trusts which enter into a business relationship in the UK and trusts which acquire real estate in the UK.
6. In relation to business relationships, a trust should only be required to register if it enters into a business relationship “in the name of the trust”. Although this is not the usual position for trusts, it would put them in the same position as companies.
7. We agree that the requirement to register should arise at the time the relationship is entered into if it is anticipated that it will last for 12 months or more.
8. Where UK real estate is acquired by trustees of a trust, the details of the trust should be registered in the Trust Registration Service. However, any corporate trustee should not be required to register as an overseas entity and should be designated an “exempt overseas entity”.

9. There should be no need for information beyond what is required by 5MLD to be collected for trusts that have no UK tax effects or which do not acquire UK real estate.
10. We agree that the initial registration deadline of 31 March 2021 should be achievable for trusts in existence on 10 March 2020. However for new trusts we consider that the deadline should be 6 months after the end of the month in which the trust is established (or funded in relation to trusts, such will trusts and trusts holding insurance policies etc).
11. The penalty regime for failure to notify (Finance Act 2008 Sch. 41) could be used as a template for any penalty regime with fixed or capped penalties unless the failure is deliberate.
12. Only those who can demonstrate a legitimate interest (and not members of the public - even if the trust owns a controlling interest in a non-EEA company) should be able to access the beneficial ownership information held in the register if the only reason for registration is that the trust is a UK taxpayer.
13. Information available to an applicant should, in relation to all trusts which appear on the register (including those which are UK taxpayers but would not otherwise be required to be registered under 4MLD/5MLD), be limited to the beneficial ownership information required to be collected under 4MLD and not any additional information the Government might choose to collect.
14. Given the lack of the legitimate interest requirement to obtain information in relation to trusts owning an interest in a non-EEA company, we consider that “controlling interest” should be given its normal meaning – ie an interest of more than 50%.
15. Any person seeking information should be required to identify the specific trust or individual in respect of which information is sought and, if relevant, the specific non-EEA company/entity controlled by the trust.

These points are all considered in more detail below.

Trust registers

Overview

EU Directive 2018/849 known as "5MLD" significantly expands the scope of the trusts which are required to be registered on a central trusts register as well as the range of people who can access the information contained in the register.

It is confirmed in the preamble to 5MLD (recital (27)) that the aim of the national law transposing the relevant provisions should be to prevent the use of trusts or similar legal arrangements for the purposes of money laundering, terrorist financing or associated predicate offences.

The preamble however goes on to recognise that a fair balance must be sought between the general public interest in the prevention of money laundering and terrorist financing and an individual's fundamental rights, including the right to respect for their private life in general and to protection of their personal data in particular (recital (34)).

It follows from this that 5MLD should be transposed by the UK Government in a way which is necessary and proportionate to achieving the relevant objectives but which does not interfere with an individual's rights in ways which are unnecessary or disproportionate. It should be recalled that under EU law:

"The principle of proportionality requires that acts of the EU institutions should be appropriate for attaining the legitimate objectives pursued by the legislation at issue and should not go beyond what is necessary in order to achieve these objectives". (Case C-151/17 *Swedish Match AB v S of S for Health* ECLI EU:C:2018:938 paragraph 35).

In this context, it is important to recognise that the UK Trust Registration Service was originally designed to perform two completely separate functions:

1. to comply with the UK's obligations under 4MLD; and

2. to ensure that HMRC had a record of trusts which are liable to pay UK tax.

This dual purpose means that the existing requirements of the Trust Registration Service go beyond what is required by 4MLD. For example, the scope of information required in relation to a trust goes beyond simple beneficial ownership information. In addition, overseas trusts which are UK taxpayers are required to register even though 4MLD only contains a registration requirement in respect of trusts governed by the law of some part of the UK.

Given the potential for public access to the information contained on the trusts register and the importance of transposing 5MLD in a way which is necessary and proportionate to its objectives, this may result in the need to have a two-tier trust registration service which differentiates between what is required for the purposes of 5MLD and what is required for domestic tax compliance purposes. This is discussed further below.

Express trusts

The registration requirements apply to express trusts and other types of legal arrangements, such as, inter alia, fiducie, certain types of Treuhand or fideicomiso when having a structure or function similar to trusts (see paragraph 1 of Article 31 of 4MLD as amended by 5MLD).

Member States are required to provide the Commission with a list of trusts and legal arrangements having a structure or functions similar to trusts which fall within Article 31.

It is clear from this that some sort of comparison must be made between trusts on the one hand and legal arrangements on the other. It follows that the types of trust (or express trusts) which fall within Article 31 should be determined not solely by reference to the trust law of the relevant part of the UK, but also by looking at whether an equivalent legal arrangement in a civil law jurisdiction would be considered to have a structure or functions similar to a trust.

In our view, most civil lawyers would regard an express trust as a settlement or will trust whereby assets are held by a trustee on trust for family members on attaining a

specified age, subject to a discretion or for persons in succession; in other words the sort of trust which can have UK inheritance tax and capital gains tax consequences.

An express trust can therefore be defined in the same kind of way as a “settlement” is defined in s43 IHTA 1984, but excluding any foreign legal arrangement that might be characterised by HMRC as a “settlement” for the purpose of s43 IHTA 1984, eg a French usufruct (see IHTM27054), but which are not regarded as such by the local law governing the arrangement.

This approach would mean the following would not be treated as “express trusts” for the purposes of Article 31 just as they would be likely to be regarded as contractual arrangements rather than trusts in civil law jurisdictions:

a. Co-ownership arrangements

This could include land, bank accounts, shares or other property. The arrangement could be contractual; or it may technically be a trust as a result for example of s36 Law of Property Act 1925.

We very much doubt however that such arrangements would be considered in a civil law jurisdiction to have a structure or functions similar to a trust.

Generally speaking, where there is a co-ownership arrangement, the legal and beneficial owners will be the same. Therefore, bearing in mind the objectives of 5MLD, there seems no reason in principle why such arrangements should be brought within the definition of an express trust.

b. Nominee (or bare trust) arrangements

Although a nominee arrangement may be established by way of contract, on a technical analysis a “bare” trust arrangement exists between the nominee and the person with the beneficial interest. The person with the beneficial interest has a proprietary interest in the assets and they do not form part of the estate of the nominee which holds as trustee.

Equivalent nominee arrangements are widely used in the EU. For example, Euroclear which acts as a central depository for securities through which

transactions are cleared. It seems highly unlikely other EU Member States would consider such a nominee arrangement (or central depository arrangement) to amount to an express trust that would have to be registered under Article 31. It seems very likely that other EU Member States would regard this as a contractual arrangement.

As there is no substantive difference between a nominee and a bare trust, there is no reason why the two arrangements should be treated differently for the purposes of Article 31, so bare trusts should also not be regarded as express trusts for 5MLD purposes.

We recognise that, as stated in recital (29) to 5MLD, one of the features of a legal arrangement that might be similar to a trust is one which enables a separation or disconnection between the legal and the beneficial ownership of assets. Therefore, even if a nominee/bare trust arrangement should not be considered as an express trust for the purposes of 5MLD, it is arguable that there should be some sort of register of beneficial ownership in respect of nominee type arrangements.

However, in our view, this would have such wide implications that it would need to be the subject of a separate EU wide initiative. For example, almost all investment arrangements with financial institutions involve investments being held by the financial institution as nominee for the ultimate client. Millions of transactions take place every day through clearing systems of which nominees form part, and every time such a transaction occurs, a new trust is constituted. It would be extremely burdensome for details of all such arrangements (of which there must be many millions) to be maintained on a central register in each EU Member State.

c. Commercial trusts

Trust arrangements are frequently used in a commercial context. This might, for example, include bond issues where security is held by a security trustee for noteholders and securitisations where receivables of principal and

interest under securitised loans are received by an originating bank on bare trust for specified parties.

In the UK such arrangements are invariably structured as bare trusts not least because of the potential tax risks associated with a settlement, although the trustee may have more contractual rights than would typically be the case with a bare trustee in other contexts.

Again, these are arrangements which, in a civil law context, would be achieved by a non-trust mechanism such as a contractual arrangement which would not be considered as the equivalent of a trust.

As mentioned above, if the EU or the wider international community wishes to bring greater transparency to the use of nominee or bare trust arrangements, our view is that this should be done explicitly for all such arrangements and not in a piecemeal fashion dealing only with those arrangements which are trust based as opposed to those which use some other non-trust mechanism. Adopting a definition of express trusts along the lines of a settlement for inheritance tax purposes would exclude such arrangements from scope.

Proportionality

Turning to the question of proportionality, recital (27) to 5MLD states:

*"(27) Rules that apply to trusts and similar legal arrangements with respect to access to information relating to their beneficial ownership should be comparable to the corresponding rules that apply to corporate and other legal entities. Due to the wide range of types of trusts that currently exists in the Union, as well as an even greater variety of similar legal arrangements, the decision on whether or not a trust or a similar legal arrangement is comparably similar to corporate and other legal entities should be taken by Member States. **The aim of the national law transposing those provisions should be to prevent the use of trusts or similar legal arrangements for the purposes of money laundering, terrorist financing or associated predicate offences.**"*

Recital (28) to 5MLD says:

*"(28) With a view to the different characteristics of trusts and similar legal arrangements, **Member States should be able, under national law and in accordance with data protection rules, to determine the level of transparency with regard to trusts and similar legal arrangements that are not comparable to corporate and other legal entities. The risks of money laundering and terrorist financing involved can differ, based on the characteristics of the type of trust or similar legal arrangement** and the understanding of those risks can evolve over time, for instance as a result of the national and supranational risk assessments. For that reason, it should be possible for Member States to provide for wider access to information on beneficial ownership of trusts and similar legal arrangements, if such access constitutes a necessary and proportionate measure with the legitimate aim of preventing the use of the financial system for the purposes of money laundering or terrorist financing. When determining the level of transparency of the beneficial ownership information of such trusts or similar legal arrangements, Member States should have due regard to the protection of fundamental rights of individuals, in particular the right to privacy and protection of personal data."*

Bearing in mind that:

- (a) the aim of a Member State, when determining the rules for accessing trust information, is to prevent the use of trusts for the purposes of money laundering, terrorist financing or associated predicate offences;
- (b) the risks of money laundering and terrorist financing involved can differ, based on the characteristics of the type of trust;
- (c) Member States have a wide discretion to decide whether or not a trust or a similar legal arrangement is comparably similar to corporate and other legal entities and the provisions of 5MLD are narrowly drafted, providing as they do that the discretion should be exercised keeping in mind the aim of preventing money laundering, terrorist financing or associated predicate offences (and are not designed to complicate the lives of ordinary citizens who may unknowingly be the beneficiaries under a trust); and that
- (d) Member States must determine the level of transparency with regard to trusts that are not comparable to corporate and other legal entities,

we consider that the types of trust described below, although they may strictly involve settlements for UK tax purposes, are sufficiently low risk as to not require registration under Article 31. In our view it would be disproportionately onerous to treat such arrangements as “express trusts” for the purposes of 5MLD. We also consider that in many cases, equivalent arrangements would be achieved by contractual means in civil law jurisdictions. Three examples of this are:

1. Trusts holding life insurance policies

A life insurance policy trust would seem to pose very little money laundering or terrorist financing risk as the life policy is in effect "dormant" until either the death of the policy holder when (if ever) the policy proceeds become payable or the surrender of the policy. The administrative burden which would be involved in registering a policy trust would be disproportionate to any perceived benefit.

The recent FATF report on the UK:

<http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-Kingdom-2018.pdf> says at paragraph 67(d)(i) that:

"The UK has the world's fourth largest insurance sector comprised of 656 general insurance firms, and 234 pensions and income retirement firms. The NRA notes that, relative to other sectors, the insurance sector in the UK is at low risk for both ML and TF. This is on the basis that, although the global nature of the London market does expose the sector to risks, firms have suitable controls to deal with them and instances of abuse have been limited."

The use of trusts to hold insurance benefits is standard estate planning practice in the UK. We understand from anecdotal evidence that there are likely to be millions of life policies written into trust. If there is an obligation to register a life policy trust, HMRC will be overwhelmed with registrations in respect of assets which are most unlikely to be used for money laundering and which may never mature if the life assured survives a specified date.

As there is no proposed grandfathering for existing trusts, there is likely to be a large degree of inadvertent non-compliance as trustees of such life policy trusts (who are often lay trustees) may have forgotten about a policy taken out many years before and will often be unaware that they are trustees. Most such trustees have not had to notify HMRC on the creation of the trust or while the life assured is alive. Life offices are likely to have records of the existence most of these trusts and may even have a copy of the trust deed showing the beneficial ownership.

Once the policy pays out on the death of the life assured, the trust should at that stage be registered unless the funds are paid out of the trust within, say, six months of the date the trustees receive the policy proceeds.

We think it likely that the equivalent arrangements in civil law countries will be purely contractual with the life office promising to pay the beneficiary directly, rather than promising to pay a trustee for the beneficiary's benefit. We would urge HM Treasury to liaise with its EU counterparts to consider whether they intend to categorise such equivalent arrangements as trust or trust-like, and if they do not, the UK Government should likewise not classify life insurance policy trusts as registrable.

For the avoidance of doubt, we are talking here only about pure life insurance (i.e. policies that only pay out on the death of the life assured) and not policies which can be surrendered, either in whole or in part, during the lifetime of the life assured for an amount calculated by reference to the value of linked investments held by the insurance company, which are little more than investment wrappers.

2. Trusts of pension or death benefits

As with life assurance policies written, or assigned into, trust (see 1 above), death benefits under old style retirement annuity contracts or retirement policies are often written in, or assigned into, trust to speed up the payment out of the death benefits and so the death benefits do not form part of the policyholder's estate on death. The trust is in effect "dormant" until the death

of the policy holder when the death benefits become payable or the surrender of the policy.

The use of trusts to hold death benefits payable from a retirement policy is standard estate planning practice in the UK. Although less common now, there are likely to be many thousands of death benefits under such policies written into trust. If trustees are under an obligation to register the retirement policy death benefits trust, HMRC will be overwhelmed with registrations in respect of assets which are most unlikely to be used for money laundering.

Again we think it likely that the equivalent arrangements in civil law countries will be purely contractual with the life office promising to pay the annuity and death benefit to the relevant beneficiary directly, rather than promising to pay a trustee for the beneficiary's benefit.

As there is no proposed grandfathering for existing trusts there is likely to be a large degree of inadvertent non-compliance as trustees of death benefits under retirement policies (who are often lay trustees) will be unaware of their obligations. Most such trustees have not had to notify HMRC on the creation of the trust or while the policyholder is alive. Pension companies who provided these policies may have records of the existence of the trusts and may even have a copy of the trust deed showing the beneficial ownership, but the trust arrangements for these types of policies may in many cases have been done by individuals privately.

The funds received into these trusts are generally payable from policies which are registered pension schemes (of which HMRC have a separate record) and the payment of a lump sum death benefit is reportable by the pension scheme administrator to HMRC in any event, so there would appear to be low risk of money laundering and terrorist financing.

The recent FATF report on the UK:

<http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-Kingdom-2018.pdf> states at paragraph 67(d)(i) that:

"The UK has the world's fourth largest insurance sector comprised of 656 general insurance firms, and 234 pensions and income retirement firms The NRA notes that, relative to other sectors, the insurance sector in the UK is at low risk for both ML and TF. This is on the basis that, although the global nature of the London market does expose the sector to risks, firms have suitable controls to deal with them and instances of abuse have been limited."

As with life policy trusts, a death benefit trust would need to be registered on the death of the relevant individual unless the proceeds are paid out of the trust within, say, six months of the date the trustees receive payment of the death benefit.

There are also various forms of trust based occupational and group (or individual) personal pension schemes that provide lifetime pension/lump sum death benefits which are generally registered pension schemes that are already registered with HMRC (under the Pension Schemes Online or Manage and Register Pension Schemes (PSO/MRPS)) and are therefore heavily regulated and so present a low risk of money laundering.

It would be reasonable therefore if the current exemption for occupational pension schemes from separately registering on the Trust Registration Service were to apply in relation to the 5MLD requirements as well (ie, that the exemption is expanded to cover all trust based registered pension schemes rather than referring only to occupational pension schemes).

3. Pilot trusts/trusts with minimal value

A pilot trust by its nature (being unfunded other than with a nominal initial trust fund) would seem to pose very little money laundering or terrorist financing risk given the low value of assets in the trust. Pilot trusts are normally established to receive funds on the death of a particular individual, either under the terms of that person's will, or as a result of a nomination relating to the death benefits under a pension policy.

A trust with assets of minimal value (for example with a UK tax liability of less than £100 on bank or building society interest income) would also seem to pose very little money laundering or terrorist financing risk given the low value of assets in the trust.

The administrative burden of registering such trusts which have minimal value would be disproportionate to any perceived benefit.

If the UK Government decides that it is necessary to require the registration of this type of trust, one solution to reduce the compliance burden would be for the regulations to provide that a trust which only holds assets with a market value below a de minimis figure (say £5,000) should not need to be registered. The trust would need to be registered as soon as the event occurs which results in the trust receiving more substantial funding.

Although 5MLD does not specifically contain any de minimis exceptions, the preamble is clear that, in order to balance the objective of preventing the use of trusts for money laundering/terrorist financing with an individual's right to privacy, the Directive should be implemented in a way which is proportionate to the stated objective. Providing an exemption from registration for trusts which pose no or a negligible risk of money laundering or terrorist financing is therefore consistent with the requirements of the Directive where failure to do so would impose an unnecessary and disproportionate burden on the trustees and an unjustified interference with the relevant individual's right to privacy.

Member States are required under paragraph 10 of Article 31 of 5MLD to provide the European Commission with a list of trusts and legal arrangements having a structure or functions similar to trusts which fall within Article 31 by 1 July 2019. The Commission has to publish the consolidated list of such trusts and similar legal arrangements by 10 September 2019.

We consider that when the UK Government comes to notify the Commission of such trusts, it should list the three types of trusts as being excluded from the category of express trusts for the purposes of Article 31.

Article 31 – Required Level of Connection with the UK

Connecting factors

4MLD/5MLD provide for specific connecting factors in order to identify which companies and trusts are required to comply with the Directives and to be registered on the central register of companies or trusts which is provided for by the Directives.

The connecting factor for companies and other legal entities has always been whether or not the entity is incorporated in an EU Member State. (See Article 30(1)).

Paragraph 1 of Article 31 of 4MLD (prior to amendment by 5MLD) imposed an obligation to collect beneficial ownership information in relation to a trust if it is “governed under” the law of a Member State.

Paragraph 4 of Article 31 of 4MLD then required the beneficial ownership information of those trusts (i.e. trusts governed by the law of a Member State) to be held in a central register if the trust generated “tax consequences”.

Given the dual nature of the Trust Registration Service, the UK Government decided to go beyond the terms of 4MLD by requiring non-UK trusts to be registered on the UK Trust Register if the trust paid UK tax even if the trust did not satisfy the threshold condition in paragraph 1 of Article 31 of 4MLD as it was not governed by the law of some part of the UK. This was not however a requirement of 4MLD.

Recital (26) of the preamble to 5MLD explains that the connecting factor for trusts and legal arrangements needs to be clarified as there are certain trusts/legal arrangements which are not monitored or registered anywhere in the EU – but which it is presumably thought have a close enough connection with an EU Member State that they should be monitored/registered. This might, for example, include a trust governed by the law of an overseas territory but which has trustees resident in England and/or which is administered in England.

The amendments made by 5MLD to Article 31 of 4MLD follow the same approach as before in setting a threshold condition in paragraph 1 and then (in new paragraph

3(a)) confirming which of the trusts that meet the threshold condition have to be registered in the central register.

Article 31 only applies to trusts which are administered in the UK

Under 5MLD, the basic condition for a trust to fall within the requirement to collect beneficial ownership information is no longer based on the governing law of the trust but instead is based on where the trust is administered. The effect of this is that the entirety of Article 31 only applies to trusts which are administered in the UK. This must be correct as it cannot be the case that beneficial ownership information in relation to a trust is required to be held in a central register if there is no obligation (under paragraph 1 of Article 31) for the trustee to collect the beneficial ownership information in the first place.

Paragraph 3(a) of Article 31 does not therefore expand the scope of trusts which are required to collect beneficial ownership information. Instead, it specifically refers back to paragraph 1 and defines a subset of the trusts within paragraph 1 (i.e. those trusts which are administered in the UK and which are required to keep beneficial ownership records) which have to appear on the central register. These are defined as follows:-

- trusts where the trustees are established in the UK or reside in the UK;
- trusts which enter into a business relationship in the UK;
- trusts which acquire real estate in the UK.

(a) Trust not administered in the UK

A trust which is not administered in the UK is not required by 5MLD to appear on the UK Trust Register even if it does meet one of these three conditions (but see later comments on trusts paying UK tax and trusts owning UK real estate).

(b) Trust administered in the UK

The UK will of course need to comply with 5MLD by requiring that all express trusts which are administered in the UK are brought within the scope of the regulations.

If a trust is administered in the UK, the UK will also need to require that trust to be registered on the UK trust register if the trustee

- (a) is established or resides in the UK. This will need to be defined – for example, is it looking at the residence of individual trustees or the tax residence of the trustees as a body?
- (b) it owns UK real estate or
- (c) it enters into a business relationship in the UK in the name of the trust.

A trust which is administered in the UK but which does not meet one of the above conditions is also not required to appear on the central register.

Administration in the UK

5MLD does not define the circumstances in which a trust is administered in a Member State. Given that this is the key connecting factor which has to be applied in determining whether a trust is subject to the requirements of the Directive, we think this should be defined as the place where the principal administrative activities relating to the trust are carried out. This would include, for example:

- (a) where the trustees meet and make decisions;
- (b) where the trust's financial and other records are kept;
- (c) where instructions for payments are made from;
- (d) where communications with service providers (such as banks, investment managers, custodians, advisers, etc) come from.

In particular, it would not, in our view, be appropriate to treat a trust as being administered in a Member State simply because the trustees have engaged a third party service provider (such as an investment manager, lawyer or accountant) in a Member State.

Trusts paying UK tax

We would expect that the UK will continue to want trusts administered outside the UK to appear on the UK Trust Register if the trust pays UK tax. This will continue the current position as far as non-UK trusts are concerned under 4MLD.

Trusts owning UK real estate

We would also expect the UK to want a trust which is not administered in the UK to appear on a UK register if it owns UK real estate. This is consistent with the proposed introduction of a requirement for non-UK companies to register in the UK before they can acquire UK real estate (as to which, see further below).

Trusts entering into business relationships

We do not however, see any reason for the UK to go beyond the requirements of 5MLD and to require a trust which otherwise has no connection with the UK to appear on the UK Trust Register simply because it enters into a business relationship with an obliged entity in the UK.

It should be recalled that under EU law:

“The principle of proportionality requires that acts of the EU institutions should be appropriate for attaining the legitimate objectives pursued by the legislation at issue and should not go beyond what is necessary in order to achieve these objectives”. (Case C-151/17 Swedish Match AB v S of S for Health ECLI EU:C:2018:938 paragraph 35).

The obliged entity will, of course, be required to collect the relevant beneficial ownership information as part of its normal AML obligations. That information will be available to the UK authorities should it be required.

The result of requiring such trusts to appear on the central register would simply be that they will enter into business relationships with service providers in other jurisdictions where there is no such requirement.

Business Relationship – in the name of the trust

We have seen legal advice which concludes that the category of trust which would be required to be registered on the central register as a result of entering into a business relationship with an obliged entity in the UK will be relatively narrow.

The reason for this is that paragraph 3a of Article 31 of 4MLD (as amended) only requires a trust to register if it enters into a business relationship “in the name of the trust”. These words must be intended to have some meaning, particularly given that the Directive draws a clear distinction between the trust on the one hand and the trustee on the other. If it had been intended to include all arrangements entered into by a trustee, there would be no need to include the words “in the name of the trust”.

In civil law countries, there is a fundamental difference between:

- (a) entering into a contract as an agent but in the agent’s own name on behalf of another person; and
- (b) entering into a contract as an agent in the name of and on behalf of another person.

In order for a trustee to be entering into a business relationship in the name of a trust, it would be necessary for the contract to name the trust (and not the trustee) as the party to the contract and for the trustee to sign the contract as a representative of the trust.

In the UK, it would be normal for the contracting party to be the trustee and for the trust not to be named as a party to the contract, even though there may be a statement in the contract that the trustee is entering into the contract in its capacity as trustee of a particular trust. This is however, different to entering into a contract in the name of the trust and so, on the wording of paragraph 3a of Article 31, would not trigger a requirement to register.

Although this may be an unfamiliar concept for an English trust lawyer, it must be remembered that the Directive is to be interpreted in an EU context and so civil law principles need to be factored in.

As mentioned above, it should be recalled that under EU Law the principle of proportionality applies (*Swedish Match AB*).

Requiring the trustee to enter into a business relationship “in the name of a trust” before registration is required means that trusts and companies are treated comparably with regard to money laundering by requiring registration only where the trust is operating as an “entity” in the same way as a company.

This achieves the legitimate objectives of 5MLD in relation to money laundering without going beyond what is necessary. Construing the provisions of paragraph 3a of Article 31 in such a way as to make them apply to all contracts entered into by non-EU trustees, would be unduly onerous and disproportionate, going beyond what is necessary to achieve the objectives of 5MLD.

Business relationship - duration

Where a trustee enters into a relationship with an obliged entity in the name of the trust, we agree that a 12 month period is a suitable element of duration in order to determine whether the relationship is a business relationship. The requirement to register should arise at the time the relationship is entered into if it is anticipated that the relationship will last for 12 months or more. If not, there should only be a requirement to register once the relationship has continued for 12 months. In practice it will be important for it to be clear what level of expectation regarding the length of the relationship will be required.

Ownership of Land

We agree that the obligation to register should mirror the existing Land Registration requirements of the relevant part of the UK.

The key issue in our view is whether, in these circumstances, the trust should be registered on the Trust Registration Service or whether it should be dealt with as part of the register of overseas entities which will be introduced in 2021.

This point is referred to in the report of the Parliamentary Joint Committee on the Draft Registration of Overseas Entities Bill which was published on 20 May 2019 (see paragraphs 76-93).

The Joint Committee did not come to a firm conclusion other than warning that trusts should not fall between two stools but equally should not be required to register twice.

There is a significant risk that an overseas trust with a corporate trustee which acquires UK real estate may be required to register twice if the transposition of 5MLD requires such a trust to register on the trust register, as the corporate trustee would also be required to appear on the Register of Overseas Entities before it could acquire the real estate in question.

A key issue is that the two registers will contain different information. The information in the Trust Registration Service will give details of the beneficial owners of the trust whereas the Register of Overseas Entities will give details of the beneficial owners of the relevant entity which, in the case of a corporate trustee, will be the beneficial owners of the trustee and not the beneficial owners of the trust.

Taking this into account, we think it is right that, where a person acquires UK real estate in its capacity as trustee of a trust, the details of the trust should be required to be registered on the Trust Registration Service but that any corporate trustee should not be required to register as an overseas entity (i.e. regulations should be made designating such a company as an “exempt overseas entity”). This would ensure that the appropriate beneficial ownership details are available without the burden of registering twice.

As mentioned above, if an overseas company is acting as a nominee or bare trustee, this should not be treated as an “express trust” and there should be no requirement for registration on the Trust Registration Service. Instead, in these circumstances, the company would need to be registered as an overseas entity in order to acquire UK real estate.

Data Collection

In order for the implementation of the 5MLD to be proportionate, HMRC should be very clear as to the extent of information that is required to be collected for 5MLD purposes. There should be no need for information beyond this to be collected for trusts that have no UK tax effects. Therefore, HMRC will need to distinguish between trusts that have UK tax effects and those that do not and should not go beyond what is required by 5MLD in relation to trusts that have no tax effects.

Registration Deadlines

We agree that a registration deadline of 31 March 2021 should be achievable for trusts in existence on 10 March 2020 (being the date by which the new register has to be established).

We think that a 30 day registration deadline for new trusts is too short given the amount of information which may need to be obtained. We would suggest that the deadline should be 6 months after the end of the month in which the trust is established (so for a trust established on 15 January, the deadline would be 31 July).

We would suggest that a similar 6 month period be allowed for the notification of changes to any of the registered information. We agree that, in the case of changes, the time should start running from the date on which the trustees become aware of the change.

Provision will need to be made in relation to trusts which come into existence under the terms of an individual's will following their death. In order to avoid any uncertainty as to whether the trust comes into existence on the individual's death or only when it receives assets under the terms of the individual's will, it should be made clear that any deadline for registration only runs from the date the trustees first receive assets under the terms of the individual's will in their capacity as trustees (and not as executors if the trustees and the executors are the same people).

If it is accepted that dormant trusts (such as life insurance trusts, pension death benefit trusts and pilot trusts) which will only be funded following the death of an individual should be exempted from registration whilst they are dormant, the deadline

for registration should again run from the date the trustees receive the relevant funding and not from the date of the individual's death.

Penalties

Although the link with tax is broken, we do not see why the penalty regime for failure to notify (Finance Act 2008 Sch, 41) cannot be used as a template, so that there is a system which takes account of degrees of culpability, the availability of a reasonable excuse and the existence of special circumstances.

Any penalty should be of a fixed amount or subject to a cap unless the failure is deliberate, in which case it might be linked to the value of the trust assets and be unlimited.

Given the number of trusts and trustees who are likely to be affected by the extended requirement to register on the Trusts Registration Service, we would urge both the UK Government and HMRC to take a pragmatic and lenient approach to penalties, especially in the early years and particularly in the case of overseas trusts and trusts which do not have professional trustees or the benefit of professional advice.

Sharing of information

As mentioned above, given the dual purpose of the UK's Trust Registration Service, some thought needs to be given as to what information should be available to those who have a legitimate interest and, in the case of trusts which own a controlling interest in a non-EEA company, to any member of the public.

It must be questionable whether information about a trust which appears on the Trust Registration Service because it is a UK taxpayer but which would not otherwise be required to register under the terms of 4MLD (as amended by 5MLD) should be available other than to law enforcement authorities. HMRC have strict duties of confidentiality in relation to information held by them in respect of all taxpayers and there is no reason why this should be any different just because the information relates to a taxpayer which happens to be a trust (trusts falling into this category will

be those trusts which are not administered in the UK but which have UK tax liabilities as a result of the ownership of UK assets).

On the other hand, it might be said that the objective of 5MLD (to prevent the use of trusts for money laundering/terrorist financing) would be compromised if those with a legitimate interest were not able to access basic information which is held in the register, even if this is as a result of the UK casting the net wider than is required by 5MLD.

On balance, we think that if our recommendations in relation to the legitimate interest test are accepted (see below), those who can demonstrate a legitimate interest should be able to access the beneficial ownership information held in the register in relation to such trusts so that all trusts which appear on the register are treated in the same way.

We do not however believe that information about such trusts should be available to any member of the public, even if the trust owns a controlling interest in a non-EEA company. This would be unnecessary and disproportionate in circumstances where the trust appears on the register solely because it has UK tax liabilities and not because it has any other UK connection which would trigger a requirement to register under 4MLD (as amended by 5MLD).

In order to respect the relevant individuals' right to privacy, the information which should be available to an applicant in all cases (and not just those trusts which appear on the register because they are UK taxpayers) should be limited to the basic beneficial ownership information required to be maintained by Article 31 and should not extend to any additional information if the Government were to decide that the Trust Registration Service should collect information which goes beyond this.

It will be important to prevent fishing expeditions in relation to trusts which own a controlling interest in a non-EEA company as in these cases information is available whether or not the person seeking the information has a legitimate interest (see further below). In order to provide the necessary safeguards, any such person should be required to identify a specific individual or a specific trust in respect of which the information is sought.

It should not, for example, be possible to make a blanket request for the beneficial ownership information of all trusts on the register which own a controlling interest in a non EEA company.

Bearing in mind the lack of any legitimate interest test for the disclosure of beneficial information, we suggest that any applicant should be required to identify the specific non EEA corporate or other legal entity owned by the trust or similar legal arrangement (and see further below our comments about the definition of “controlling interest”).

Legitimate Interest

The main purpose of the trust register is to prevent the use of trusts or similar legal arrangements for the purposes of money laundering, terrorist financing or associated predicate offences (recital (27) of the preamble to 5MLD).

It is therefore right, as proposed in the consultation paper, that any test as to whether a person has a legitimate interest in accessing the information contained in the register should be seen in this context.

In addition, Member States must have due regard to the protection of fundamental rights of individuals, in particular the right to privacy and protection of personal data (recital (28) to 5MLD).

In order to draw an appropriate balance between these two principles, it is important that the test for legitimate interest is not drawn so narrowly that it obstructs the ability of the person seeking the information to obtain evidence of money laundering or terrorist financing but at the same time the test must prevent speculative enquiries, fishing expeditions or people trying to obtain information who, in reality, want it for some other purpose.

In order to balance these competing objectives, we would propose a test similar to that suggested in paragraph 9.45 of the consultation paper but with a little more flexibility as to what evidence must be provided in order to support the application.

On this basis, the person seeking disclosure must:-

- 1 be involved in an investigation relating to money laundering or terrorist financing;
- 2 believe that the particular trust or the particular individual in relation to which disclosure is sought is involved with the money laundering or terrorist financing in question;
- 3 produce evidence based on which it would be reasonable to conclude that their belief is objectively reasonable – ie the evidence must show that there is more than just a vague suspicion but does not need to go so far as to prove (even on the civil standard of the balance of probabilities) the involvement of the relevant trust or individual.

The following safeguards should be provided:-

- a) unless it would prejudice an ongoing criminal investigation, the relevant individual or the trustees of the relevant trust should be notified of the application for disclosure, with full details of the name and address of the person seeking disclosure and the basis for of the legitimate interest claim;
- b) the trustee/individual should have the right to make representations before any decision is made in relation to the disclosure application;
- c) there should be a right of appeal to a tribunal against HMRC's decision in relation to disclosure (and not just a right to apply for judicial review);
- d) it should be a criminal offence for the person receiving the information to use it for any purpose other than the relevant investigation in relation to money laundering/terrorist financing or to pass the information on to any other person in the knowledge that it would or may be used for any other such purpose.

We note that recital (38) of the preamble to 5MLD anticipates that a beneficial owner may be notified of any request for disclosure that that recital (42) contemplates the possibility of appeal rights against decisions which grant or deny access to beneficial ownership information.

Non-EEA Companies

If a trust which is required to register on the Trust Registration Service holds or owns a controlling interest in a non-EEA corporate or other legal entity, any person may obtain the beneficial ownership information in relation to the trust whether or not they have a legitimate interest.

It is not clear why the ownership of a controlling interest in a non-EEA company should justify a complete loss of privacy but this is nonetheless a clear requirement of 5MLD and so must be transposed in the UK law.

It is worth noting that most overseas trusts will typically hold assets through a non-EEA holding company. This means that if the overseas trust is required to register with the Trust Registration Service, information about the beneficial ownership of the trust would, in effect, be public. This adds significantly to the concern that overseas trusts will engage service providers outside the EU if, contrary to the requirements of 5MLD, the UK transposes the directive in such a way that an overseas trust with no other connection with the UK has to register simply because it enters into a business relationship with an obliged entity in the UK.

As there is no legitimate interest test for the disclosure of beneficial ownership information in these circumstances, we do not consider it appropriate to define “controlling interest” in the same way as for the purposes of the PSC Register. It is recognised that, in the case of trusts, there is a tension between preventing money laundering and terrorist financing on the one hand and an individual’s right to privacy on the other. It would be disproportionate to dilute the safeguards in relation to the disclosure of beneficial ownership information in circumstances where a trust only holds a minority interest in a non-EEA company. We therefore believe that “controlling interest” should be given its normal meaning – ie an interest of more than 50%.

We accept that some other means of control based on the PSC statutory guidance on the meaning of “significant influence or control” should also be sufficient to make an interest in such a company a “controlling interest”.

On the question as to what is meant by the expression “other legal entity”, it is clear from 4MLD as a whole that there is a distinction between corporate and other legal entities on the one hand and trusts and other legal arrangements on the other.

Article 30 refers to corporate and other legal entities which are incorporated in a particular Member State. Although this might suggest that a legal entity and a corporate entity are in fact the same thing, the underlying intention is surely that a legal entity (like a corporate entity) must be a separate legal person whilst a trust or a similar legal arrangement is not a separate legal person.

We do not think that it is therefore right to say (see paragraph 9.54 of the consultation paper) that “other legal entity” would typically include “charities, unincorporated associations and non-governmental organisations; collective investment schemes; trusts and their equivalent from other legal systems”.

In order to avoid any doubt in relation to this, a legal entity should specifically be defined as an entity other than a corporate entity (or body corporate) which has separate legal personality. A UK example of this would be a Scottish limited partnership.

We agree that simple self-declaration by the trustee in relation to the ownership of a controlling interest in a corporate or other legal entity is the only viable way of capturing this information. There is no point in asking for proof that a trust owns a controlling interest in a non-EEA company given that the only consequence of having a controlling interest is that members of the public can freely access beneficial ownership information in relation to the relevant trust. No trustee is therefore going to say that the trust owns a controlling interest in a non-EEA company if it does not.

The problem, of course, is identifying those trusts which own a controlling interest in a non-EEA company if this information is not declared by the trustees but there is no obvious way of identifying such omissions (unless an obliged entity reports it as being a discrepancy between the KYC information which it obtains and the information contained in the Trust Registration Service).

General points

We are extremely concerned that there may not be time for proper consultation on the draft regulations implementing 5MLD. In order to avoid similar problems to those which arose in relation to the transposition of 4MLD as far as trusts are concerned, it is vital that there is sufficient time for proper consultation so that any potential problems can be ironed out.

It is also very important that this part of the regulations are either drafted or reviewed by somebody who has a sufficient understanding of trusts and trust law in the various different parts of the UK.

In addition, it is going to be important to have detailed guidance available well before the updated Trust Registration Service comes into effect on 10 March 2020. In effect, this means that the guidance must be finalised by the end of 2019 in order to give people sufficient time to understand exactly what will be required. As with the draft regulations, it will be important that there is sufficient time for consultation in relation to the draft guidance before it is finalised.

Submitted by STEP Technical Committee on 10 June 2019