



RUDGE REVENUE REVIEW

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A SERVILE LEGACY: 'GOLD-PLATING' THE FIFTH ANTI-MONEY LAUNDERING DIRECTIVE¹

THE FOURTH MLD AND THE TRUST REGISTER

Directive (EU) 2015/849 (on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing) (the 'Fourth MLD') Art. 31 imposed on each Member State of the European Union a duty to require certain categories of trustees to obtain and hold various information about the trusts concerned and to submit information to a central register (the 'Trust Register') maintained by the Member State.² In obedience to that duty, the UK made the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (the 'MLD Regulations').

The introduction of the Trust Register in June 2017 was fraught with teething problems and the requirement to register has proved very burdensome adding substantially to the cost of trust administration.

THE FIFTH MLD

On the 9th July 2018 the Directive (EU) 2018/843 (the 'Fifth MLD'),³ which had been passed on 30th May 2018, came into force.⁴ The Fifth MLD amends the Fourth MLD in various ways which are of significance to tax practitioners but the changes which it makes of most significance to such practitioners are in respect of the Trust Register and in identifying in respect of which trusts, trustees must obtain, hold and register information.

TRANSPOSITION INTO UK LAW

EU Directives are binding as to the result to be achieved, upon each Member State to which they are addressed⁵ but it is for the national authorities to determine the manner in which directives are to be implemented.⁶ It is for the national authorities, therefore, to transpose them into their law which they must do by a date, or dates, prescribed in the directive concerned. Until that date, or dates, the directive has no direct effect in the national laws of the states concerned.⁷ If the directive is correctly transposed into a country's law, the directive will continue to have no direct effect in the law of that country. Even if it is not transposed, or is not fully or accurately transposed, into the national law it will have direct effect only if, had the directive concerned been completely and accurately transposed, the rights which national law would have conferred but which were not conferred under the actual transposition can be clearly and precisely determined and would have been unconditional.⁸

¹ A shortened version of this review appeared in the December issue of 'Tax Adviser' under the title 'The Perils of Gold-Plating'

² Fourth MLD Art. 31(1) & (3) (before amendment by the Fifth MLD)

³ We refer to the Fourth MLD and the Fifth MLD together as the 'MLDs'

⁴ Fifth MLD Art. 5: Official Journal of the European Union 19th June 2018

⁵ Treaty on the Functioning of the European Union ('TFEU') Art. 288

⁶ TFEU Art. 288

⁷ Simon's Taxes para. A2.208

⁸ *Van Gend en Loos v Nederlandse Administratie Der Belastingen* [1963] CMLR 105; *R v Secretary of State Home Affairs ex parte Santillo* (Case 131/79) ECA 1585. It is illustrative of the differing attitudes to conformity with EU law that have prevailed in the UK and in the other Member States that a year after the date which it provided for its transposition into national laws twenty other Member States had not transposed the Fourth MLD, in its original form, into their laws

The Fifth MLD provides that it must be transposed into the national law of the Member States by 10th January 2020⁹ and that amended Trust Registers must be in place by 10th March 2020.¹⁰ We shall not have left the European Union by 10th January 2020 but it now appears highly likely that we shall have done so by 10th March 2020.

The Withdrawal Act

The European Union (Withdrawal) Act 2018 (the 'Withdrawal Act') provides for the continuing effectiveness after Brexit Day of 'EU derived domestic legislation'¹¹ and of 'direct EU legislation'.¹² A directive which the UK is under a duty to have transposed into UK law before Brexit Day falls within these provisions.¹³

The ConDoc

In April 2019, HM Treasury published a consultation document entitled '*Transposition of the Fifth Money Laundering Directive: consultation*' (the 'ConDoc') as to how this transposition might be achieved. As we have seen, the Fifth MLD provides that it must be transposed into national law by 10th January 2020. The ConDoc says that:-

*'A more detailed technical consultation run by HMRC will be published later this year. This will include additional information on the proposals for data collection, data sharing and penalties, taking into account responses to this consultation.'*¹⁴

At the time of writing that more detailed technical consultation has not been published and it seems unlikely that it will have been published by 10th January 2020. Indeed, the Government has not even published a summary of the responses it has received to the ConDoc. It appears, therefore, that on 10th January 2020 the Fifth MLD will have direct effect in English Law although, because the rules in respect of amended trust registers will not be effective until 10th March 2020, its direct effect will, at first, be limited.

In the ConDoc the Government proposes that registrable trusts already in existence at 10th March 2020 which were not registrable under the Fourth MLD before its amendment by the Fifth MLD, must be registered by 31st March 2021.¹⁵ Registrable trusts created on or after 1st April 2020 must be registered within thirty days of their creation.¹⁶ It is not clear when registerable trusts created between 10th March and 31st March 2020 will have to be registered.

Gold-plating

The ConDoc was written on the assumption that the UK would transpose the Fifth MLD into UK law. In doing so, the Government specifically proposed to 'gold-plate' the Fifth MLD.¹⁷ 'Gold-plating' refers to the Government's practice, in transposing EU Directives into UK law, of unilaterally imposing additional burdens on individuals and legal persons which it has no duty to impose under EU law. It says it will do so, however, only where 'there is good evidence that a material ML [Money Laundering]/TF [Terrorist Funding] risk exists that must be addressed.'¹⁸ One hopes, but without great confidence, that, although it does not say so expressly, the Government's intention is only to 'gold-plate' its transposition where the risk is not adequately addressed by the express provisions of the Fifth MLD.

⁹ Fifth MLD Art. 4(1)

¹⁰ Fifth MLD Art. 1(42) substituting a new Art. 67(1) in the Fourth MLD

¹¹ Withdrawal Act s.2(1)

¹² Withdrawal Act s.3(1)

¹³ Withdrawal Act s.4(2)(b)

¹⁴ ConDoc para. 9.4

¹⁵ ConDoc para. 9.28

¹⁶ ConDoc para. 9.29

¹⁷ ConDoc para. 1.11

¹⁸ ConDoc para. 1.13

When one considers that the UK Government has already adopted a 'gold-plated' approach in transposing the Fourth MLD and that the European Commission has gone through the process of considering what enhancements of the Fourth MLD are required in formulating the Fifth MLD one would think that, if the UK Government were really to limit its 'gold-plating' of the Fifth MLD as it says it will, no such 'gold-plating' would be required.

Perseverance

Whether, now that our Prime Minister and much of the personnel of the Cabinet has changed, the Government still intends that the Fifth MLD should be transposed into UK law and whether, if it is, the Government will indulge once again in 'gold-plating' is unclear. The Government, however, is unlikely to want to run the risk of being portrayed as being 'soft' on money laundering and the ConDoc is written in such an enthusiastic tone that it is not to be expected that the officials dealing with it will easily resile from their proposals to impose yet further burdens on UK professional and business activities. We shall assume in this review, therefore, that the ConDoc continues to represent the UK Government's view of the matter.

THE NEXUS WITH A MEMBER STATE

Previous Nexus – governed by Member States' law

Before its amendment by the Fifth MLD, Fourth MLD Art. 31(1) provided that:-

'Member States shall require that trustees of any express trust governed under their law obtain and hold adequate, accurate and up-to-date information on beneficial ownership regarding the trust.'

This information only had to be kept on a central register, however, when 'the trust generate[d] tax consequences'.¹⁹

Thus, under the Fourth MLD (before amendment), the only trustees who were to be required to obtain and hold information on beneficial ownership were trustees of trusts governed by the law of the Member States so that the UK only had a duty to require the requisite information to be obtained, held and registered by trustees of 'express' trusts governed by UK law.²⁰ In the MLD Regulations, however, the government defined a 'relevant trust,' that is a trust subject to the duty to obtain or hold information, as being:-

*'(i) a UK trust which is an express trust; or
(ii) a non-UK trust which is an express trust; and
(aa) receives income from a source in the United Kingdom; or
(bb) has assets in the United Kingdom,
on which it is liable to pay one or more of ... [Income Tax, Capital Gains Tax, Inheritance Tax, Stamp Duty Land Tax, Land and Buildings Transaction Tax and Stamp Duty Reserve Tax (the 'Prescribed Taxes')]...'*²¹

For this purpose:-

*'(c) a trust is a "UK trust" if—
... all the trustees are resident in the United Kingdom; or
...
(i) at least one trustee is resident in the United Kingdom, and
(ii) the settlor was resident and domiciled in the United Kingdom at the time when—
(aa) the trust was set up, or*

¹⁹ Fourth MLD Art. 31(4) (before amendment by the Fifth MLD)

²⁰ In this review we use 'UK law' as a convenient shorthand for the law of one of the constituent kingdoms of the UK

²¹ MLD Regulations Reg. 42(2)(b)

(bb) the settlor added funds to the trust;
(e) a trust is a “non-UK trust” if it is not a UK trust;²²

‘Gold-Plating’

Plainly this went beyond imposing the duty only on trustees of trusts governed by UK law and so constituted a considerable degree of ‘gold-plating’.

Restriction of registration requirement to ‘taxable relevant trusts’

Under the MLD Regulations, however, trustees only have a duty to register trust information if they are trustees of a taxable relevant trust.²³ A taxable relevant trust is:-

*‘...a relevant trust in any year in which its trustees are liable to pay any of the [Prescribed Taxes] in the United Kingdom in relation to assets or income of the trust’*²⁴

Revised Nexus: place of administration

The Fifth MLD both extends the application of Art. 31 to ‘*other types of legal arrangements, such as, inter alia, fiducie, certain types of Treuhand or fideicomiso, where such arrangements have a structure or functions similar to trusts*’²⁵ and changes the nexus with a Member State which subjects trustees to a duty to obtain, hold and register information.

The trustees who have a duty to hold, obtain and register information under the provisions of the revised Fourth MLD are now:-

*‘trustees of any express trust administered in [the] Member State [concerned].’*²⁶

Thus, the nexus connecting trustees to a Member State is changed from the governing law of the trust to the place where the trust is administered. The Fifth MLD contains no proposals as to how the place of administration is to be determined nor is any definition proposed in the ConDoc.²⁷

Fourth MLD Art. 31(3a)²⁸ contains provisions to determine on which Member State’s trust register, information in respect of a trust is to be held. It must be held where the trustees (or equivalent persons in respect of similar arrangements) are established or reside except that where the trustees (or equivalents) are established or reside outside the EU, the information must be held on the register where the trustee ‘*enters into a business relationship or acquires real estate in the name of the trust or similar legal arrangement.*’ There are also tie-breaker provisions where the trustees are established or reside in more than one EU jurisdiction or no trustee (or equivalent) resides in an EU jurisdiction and the trustees (or equivalents) have business relationships with more than one EU jurisdiction.

The ConDoc’s incorrect construction

The ConDoc says:-

‘...5MLD expands the scope of the register, and the following trusts will have to be registered:

- *all UK resident “express trusts” – as opposed to only those express trusts with UK tax liabilities as at present. (UK resident for this purpose is where(a) all trustees are UK resident or (b) where there is a mixture of UK and non-UK trustees and the settlor is a UK resident)*

²² MLD Regulations Reg. 42(2)(c), (d) & (e)

²³ MLD Regulations Reg. 45(2)

²⁴ MLD Regulations Reg. 45(14)

²⁵ Fourth MLD Art. 31(1) (as amended by the Fifth MLD)

²⁶ Fourth MLD Art. 31(1) (as amended by the Fifth MLD)

²⁷ Apart perhaps, from one enigmatic reference to ‘non-EU resident express trusts that are deemed to be administered in the UK ...’ (ConDoc para. 9.19)

²⁸ As amended by the Fifth MLD

- *non-EU resident express trusts that acquire UK land or property either on or after 10 March 2020*
- *non-EU resident express trusts that enter into a **new** business relationship with an obliged entity on or after 10 March 2020*²⁹

In their responses to the ConDoc both the CIOT³⁰ and the STEP³¹ said that this was an incorrect construction of the Fifth MLD. They pointed out³² that the revised Art. 31(1) states the condition which must be satisfied for a duty to be imposed on the trustees of a trust to collect beneficial ownership information. As we have seen, the Fifth MLD imposes this duty by reference to the place where the trust is administered. The information that Art. 31(3a) provides must be held in a central beneficial ownership register is the information referred to in Art. 31(1); that is only information in respect of express trusts (and, arguably, similar arrangements) administered in the Member State concerned which is to be obtained and collected by the trustees of those trusts. The provisions of Art. 31(3a) in respect of trustees entering into a business relationship or acquiring real estate are concerned only with identifying the Trust Register on which the information must be held and not with determining the trusts to which the duty to provide that information relates.

The first bullet point is also not correct. As we have seen, the nexus which the Fifth MLD uses to define what express trusts are subject to Art. 31 is the place where the trust is administered. The nexus is not formed by the residence of the trustees although it may well be that in most cases a trust administered in the UK will also be resident here.

More ‘gold-plating’

The ConDoc’s construction of the provisions of the Fifth MLD in respect of which trustees of express trusts will be subject to a duty to obtain, hold and register information is, therefore, inaccurate and represents a considerable ‘gold-plating’ of the Fifth MLD’s provisions.

As the STEP said in its response to the ConDoc:-

‘We do not ... 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.

...

*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.’*³³

Driving business away from the UK

The ConDoc’s proposals, therefore, provide a good example of our officials’ tendency to drive business away from the UK by ‘gold-plating’ EU requirements.

‘EXPRESS TRUSTS’

We have seen that Art. 31, both before and after its amendment by the Fifth MLD, applies only to ‘express trusts’. Unfortunately the MLDs are clearly written by persons who have little familiarity or understanding of the nature of trusts. The Fifth MLD refers repeatedly to the

²⁹ ConDoc para. 9.7

³⁰ HMT Consultation on the Transposition of the Fifth Money Laundering Directive: Response by the Chartered Institute of Taxation 10th June 2019 (the ‘CIOT Submission’) para. 8.9

³¹ STEP’s Response to HM Treasury’s Consultation on the Transposition of the Fifth Money Laundering Directive published on 15th April 2019 – 10th June 2019 ((the ‘STEP Submission’) pg. 16)

³² CIOT Submission para. 11.1 and STEP Submission pg. 16

³³ STEP Submission pg. 18

'beneficial ownership' of trusts as if trusts were a form of property rather than property being subject to trusts and to persons entering into a business relationship with a trust rather than with the trustees. Even if the Fifth MLD were drafted with a greater understanding of the nature of trusts the difficulty of the phrase 'express trusts' would remain because the MLDs contain no definition of that phrase. Even in English usage it is not a phrase with a universally agreed definition. Halsbury's Laws tentatively defines express trusts as:-

'...
[those] which are created expressly or impliedly by the actual terms of some instrument or declaration, or which by some enactment are expressly imposed on persons in relation to some property vested in them, whether or not they are already trustees of that property; [in counter distinction to]
... trusts arising by operation of law (other than express trusts imposed by enactments)' ³⁴

It is clear from the ConDoc that the Government considers that the phrase as it is used in the Fifth MLD is to be broadly defined in a way similar to the definition given above from Halsbury's Laws. The ConDoc says, for example:-

'5MLD requires the UK to register all UK resident "express trusts" and does not provide scope for carve outs, exemptions, or de minimis thresholds. The term "express trust" is generally defined as a trust that was expressly (i.e. deliberately) created by a settlor, as opposed to being created in other ways – for example, through a court order or through statute. It arises through the settlor's declaration of an intention to enter into a transaction and can be created, for example, by a written trust deed or under a will.

...
...we ... set out below examples of the categories of UK trusts that are likely to fall within the definition of an express trust and therefore will have to register:

- discretionary trusts
- interest in possession trusts
- many types of bare trusts ³⁵
- charitable trusts
- employee ownership trusts' ³⁶

If the Government does take this view of the meaning of 'express trusts' in the Fifth MLD it will enormously expand the class of trustees who must obtain, hold and register information under its transposition of the MLDs. The Government's construction would bring within the scope of the MLDs, bare trusts, including nominee arrangements and trusts where property is held for a minor who becomes absolutely entitled at the age of 18,³⁷ co-ownership arrangements,³⁸ commercial trusts³⁹ such as the holding by a trustee of security in a bond issue, pilot trusts⁴⁰ and trusts holding life insurance policies⁴¹ and death benefits under pension arrangements.⁴²

Of course, if that is the true construction of the Fifth MLD, the Government would be under a duty to adopt that construction in transposing the Fifth MLD into UK law. Both the CIOT and the STEP argue, however, that it is not a correct construction of the phrase as it is used in the Fifth MLD. The CIOT explained:-

³⁴ Halsbury's Laws of England / Trusts and Powers (Volume 98 (2019)) para. 24

³⁵ It is not at all clear why under this broad view of the meaning of the phrase only some bare trusts would fall within the definition when all interest in possession trusts would do so

³⁶ ConDoc paras. 9.10 - 9.12

³⁷ CIOT Submission paras. 8.9 – 8.12

³⁸ STEP Submission pg. 6

³⁹ STEP Submission pgs. 7 & 8

⁴⁰ STEP Submission pgs. 13 & 14

⁴¹ STEP Submission pgs. 10 & 11

⁴² STEP Submission pgs. 11 - 13

'As European legislation adopts a purposive, principles-based approach to legislative drafting, the recitals to the [Fifth MLD] provide the framework for determining the UK's overall approach to the definition of an express trust.

Recital (27) indicates that;

"Due to the wide range of types of trusts that currently exists in the Union, as well as an even greater variety of similar 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."

*Note that this sentence explicitly envisages that each Member State needs to decide whether a trust or similar legal arrangement is "similar to corporate and other legal entities". The need for such a decision would not arise if anything called a "trust" were required to be treated as an "entity" in any case. We believe however that the point of this exercise is to look to the Member States to identify what is an "entity" of the sort envisaged and what is not.'*⁴³

Both the CIOT and the STEP in their responses made a close analysis of the Fifth MLD's statements of its purpose and of the nature of its proposals in relation to the collection of information by trustees and its registration in the light of those statements and came to similar conclusions.

The CIOT said:-

*'In broad terms, the European understanding of a trust is not dissimilar to the "wider" trust characteristics [which had previously been set out in the CIOT Submission]: a structure or "entity" with multiple beneficiaries which is either discretionary or confers successive interests. In UK tax terms this approach is currently recognised both in the IHT definition of settlement (Inheritance Tax Act 1984, section 43) and the Capital Gains Tax and Income Tax definitions of settled property (Taxation of Capital Gains Act 1992, section 68 and Income Tax Act 2007, section 466).'*⁴⁴

The STEP similarly concluded:-

*'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, but which are not regarded as such by the local law governing the arrangement.'*⁴⁵

The STEP also suggested that:-

'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

⁴³ CIOT Submission para. 8.2

⁴⁴ CIOT Submission para. 8.5

⁴⁵ STEP Submission pg. 6

*burden on the trustees and an unjustified interference with the relevant individual's right to privacy.'*⁴⁶

The STEP concluded, therefore, that even though, as it considered, express trusts for the purposes of the MLDs are, in general, those trusts which would fall within the definition of a 'settlement' in IHTA 1984 s.43, three categories of trust which fall within s.43, being trusts holding life insurance policies, death benefits under pension arrangements and trusts holding property of minimal value, are not within the ambit of the phrase 'express trusts' as it is used in the Fifth MLD. The STEP's conclusion was, therefore, that applying a purposive construction of the Fifth MLD has the result that the Government should not apply a broad construction of the phrase 'express trusts' in its transposition of the amendments made to the Fourth MLD by the Fifth MLD into UK law and that where the amended Fourth MLD uses the phrase 'express trusts,' it refers to trusts expressly declared by the settlor of the types falling within the definition of a settlement of IHTA 1984 s.43 other than pilot trusts, trusts of life insurance policies and of death benefits arising under pension arrangements.

CONCLUSION

The ConDoc's failure to properly take account of the provisions of the amended Art. 31(1) restricting the trustees to which Art. 31 applies to trusts governed by the law of the Member State concerned and of the Fifth MLD's statements of its purpose in constructing the phrase 'express trusts' will result, unless the Government reconsiders its position, in a wholly unnecessary extension of the class of trusts in respect of which trustees will have a duty, under UK law, to obtain, hold and register trust information. That will drive business away from the UK and increase the cost of administering useful family and commercial trusts without any significant benefit in preventing money laundering or the financing of terrorist activities. It may be that the Government will now abandon its decision to 'gold-plate' the transposition of the Fifth MLD into UK law but, if it does not, the professional bodies should continue to urge the Government to restrain its declared intention to do so and to refrain from extending unnecessarily what is already a significantly burdensome extension of EU law.

⁴⁶ STEP Submission pg. 14