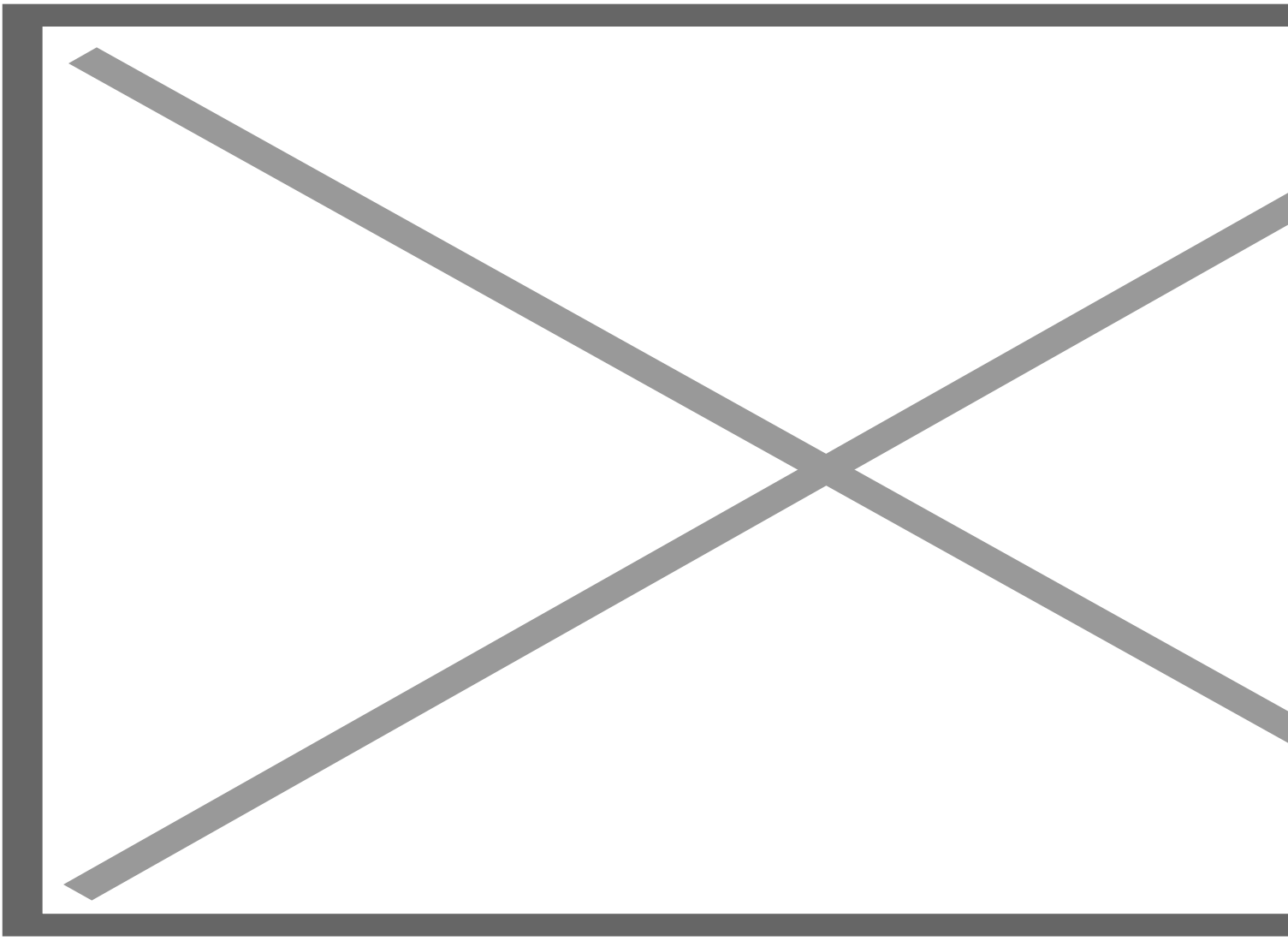
The perils of gold plating

Personal tax



01 December 2019

Simon McKie and *Sharon McKie* examine the additional burdens which will be placed on trustees if the Fifth Anti-Money Laundering Directive is transposed into UK law

Key Points

What is the issue?

The Fifth MLD provides that it must be transposed into the national law of the member states by 10 January 2020 and that amended Trust Registers must be in place by 10 March 2020.

What does it mean for me?

If the government were to follow the views put forward in its consultation documents, it would enormously expand the class of trustees who must obtain, hold and register information.

What can I take away?

The scope of the MLD Regulations would be extended to include bare trusts, co-ownership arrangements, commercial trusts, pilot trusts and trusts holding life insurance policies and death benefits under pension arrangements.

Article 31 of Directive (EU) 2015/849 (the 'Fourth Money Laundering Directive (MLD)') imposed on each EU member state a duty to require certain categories of trustees to obtain and hold various information about their trusts and to submit information to a central register (the 'Trust Register') maintained by the member state. In obedience to that duty, the UK made regulations transposing the Fourth MLD into UK law (the 'MLD Regulations').

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

The Directive (EU) 2018/843 (the 'Fifth MLD'), which came into force on 9 July 2018, made significant changes to the Fourth MLD in respect of the Trust Register and in determining which classes of trustees must obtain, hold and register information.

The Fifth MLD provides that it must be transposed into the national law of the member states by 10 January 2020 and that amended Trust Registers must be in place by 10 March 2020.

In the unlikely event that we were to leave the EU before 10 January 2020, the UK will not be bound to make the amendments directed by the Fifth MLD, nor will the Fifth MLD be directly effective in UK law. If the Withdrawal Agreement, however, becomes effective without the relevant provision being modified, it would require the UK to transpose the Fifth MLD into its law by the date stated in the Directive.

The consultation

In April 2019, HM Treasury published a consultation document entitled 'Transposition of the Fifth Money Laundering Directive: consultation' (the 'ConDoc') on how this transposition might be achieved. It says:

> '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.'

That consultation has not been published and there is now almost no time for the government to consider any responses it would receive if it were to publish it.
The government proposes that registrable trusts already in existence at 10 March 2020, which were not registrable under the Fourth MLD before its amendment by the Fifth MLD, must be registered by 31 March 2021. Registrable trusts created on or after 1 April 2020 must be registered within 30 days of their creation.

The ConDoc was written on the assumption that the UK would be obliged to transpose the Fifth MLD into UK law. In doing so, the government specifically proposed to 'gold plate' the Fifth MLD.

‘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 money laundering or terrorist funding risk exists that must be addressed’.

Whether the government still intends the Fifth MLD to be transposed into UK law and whether, if it is, the government will indulge once again in ‘gold plating’ is now unclear but we shall assume in this article 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

Under the Fourth MLD (before amendment), the only trustees required to obtain and hold information on beneficial ownership were those of trusts governed by the law of a member state. 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. Under the current MLD Regulations, however, the government defined a trust subject to the duty to obtain or hold information, as being:

1. a UK trust (broadly, a trust which is resident in the UK for income tax and CGT purposes) which is an express trust; or
2. a non-UK trust which is an express trust; and

    - receives income from a source in the United Kingdom; or
    - has assets in the United Kingdom on which it is liable to pay one or more of the main taxes borne by individuals (the ‘Prescribed Taxes’).
      (MLD Regulations Reg. 42(2)(b))

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’.

Under the current MLD Regulations, trustees only have a duty to register trust information if they are trustees of a taxable relevant trust (MLD Regulations Reg 45(2)).

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.’ (MLD Regulations Reg 45(14))

Revised nexus: place of administration

The Fifth MLD both:

- extends the application of Article 31 to **‘other types of legal arrangements … [which] have a structure or functions similar to trusts’**; and
- changes the nexus with a member state which subjects trustees to a duty to obtain, hold and register information.

Such trustees are now ‘trustees of any express trust administered in [the] member state [concerned].’

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 Fourth MLD Article 31(3a) (as inserted by the Fifth MLD) contains provisions to determine on which member state's Trust Register information in respect of a trust is to be held. Under these provisions, the places where the trustees enter into business relationships and acquire 'real estate' are of significance.

The ConDoc's incorrect construction

The ConDoc says that the Fifth MLD:

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

In their responses to the ConDoc, both the CIOT (the 'CIOT Submission') and the STEP (the 'STEP Submission') said that this was an incorrect construction of the Fifth MLD. They pointed out that the revised Article 31(1) states that the Fifth MLD imposes this duty on trustees of a trust to collect beneficial ownership information by reference to the place where the trust is administered.

The information that Article 31(3a) provides must be held in a central beneficial ownership register is that referred to in Article 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 Article 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 to which trusts the duty to provide that information relates.

The ConDoc's construction 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 the Fifth MLD 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.'

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 Article 31, both before and after its amendment by the Fifth MLD, applies only to 'express trusts'. 'Express trusts' is not a phrase with a universally agreed definition. Halsbury's Laws of England

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).' (*Trusts and Powers* (Vol 98 (2019)) para 24)

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. The ConDoc says, for example, that the Fifth MLD:

> '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 gives examples of the trusts that trustees will have to register as including discretionary trusts, interest in possession trusts, many types of bare trusts, charitable trusts, and employee ownership trusts. If the government were to take this view, it would enormously expand the class of trustees who must obtain, hold and register information, and would bring within the scope of the MLD Regulations bare trusts, including nominee arrangements and trusts where property is held for a minor who becomes absolutely entitled at the age of 18, co-ownership arrangements, commercial trusts such as the holding by a trustee of security in a bond issue, pilot trusts and trusts holding life insurance policies and death benefits under pension arrangements (STEP Submission).

Of course, if that is the true construction of the Fifth MLD and we have not left the EU by 10 January 2020, or we enter into the Withdrawal Agreement, the government would have a duty to adopt it in transposing the Fifth MLD into UK law. Both the CIOT and the STEP argued, however, that it is an incorrect construction of the phrase as it is used in the Fifth MLD. The CIOT explained: '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.'

Both the CIOT and the STEP 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 s 43) and the capital gains tax and income tax definitions of settled property.'

The STEP concluded similarly that trusts holding life insurance policies, death benefits under pension arrangements and property of minimal value which fall within the definition in IHTA 1984 s 43 do not fall within the ambit of the phrase 'express trusts' as it is used in the Fifth MLD. It concluded, therefore, that applying a purposive construction of the Fifth MLD has the result that in its transposition of the Fifth MLD into UK law, the government should not apply a broad construction of the phrase 'express trusts' because 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 within IHTA 1984 s 43 other than trusts holding life insurance policies, death benefits under pension arrangements and property of minimal value.

Conclusion

The ConDoc fails to properly construe the amended Article 31(1) so as to restrict the trusts to which Article 31 applies to trusts governed by the law of the member state concerned, and to consider the Fifth MLD's statements of its purpose in constructing the phrase 'express trusts'. Unless the government reconsiders its position, this will result 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 Brexit will save us from that but, if it does not, the professional bodies should continue to encourage the government to restrain its urge to 'gold plate' what is already a significantly burdensome extension of EU law.

We are grateful for the comments by John Barnett of Burges Salmon LLP.