



The case for registering trusts – and how to do it

Andres Knobel

November 3, 2016

Executive Summary

Trusts are powerful and often highly complex legal instruments. They are widely used in some countries like the U.S. and the UK for legitimate reasons, though they are also frequently abused to evade taxes and commit other crimes and misdemeanours.

The key question we address here is this:

Trusts can own assets¹ but they often serve as ‘secrecy shields’ preventing us from finding out who owns those assets. We think that in a democracy it is important for the forces of law and order and even regular citizens, to be able to find out who owns the registrable assets located there. That new \$20 million apartment block in your neighbourhood is owned by an offshore trust, but nobody can find out who really owns or controls or benefits from it: could it be the public officer approving the planning permissions?

Currently there is some disagreement, even among some civil society organizations, about where to set the bar. Some consider that the costs and complexities of registration are impractical, especially with regard to trusts. Trusts are potentially more slippery and difficult to tackle than shell companies, and millions of people, even people who aren’t that rich, are involved with trusts: some feel that deep reform, would just be too big a job to countenance. In essence, those who highlight the difficulties argue that stronger rules for

What is a trust?

A classic trust is a three-way arrangement. The original owner of assets (the **settlor** or **grantor**) transfers them into the trust to be held and managed by a **trustee** or trustees, for the benefit of “**beneficiaries**”.

Those assets could be anything: a Picasso, a yacht, a Swiss bank account, or a shell company owning all the above. A “**trust deed**” is a set of instructions as to who gets what, and when. Courts usually accept these (often secret) arrangements as valid.

¹ Whether directly or in the name of the trustee

service providers and financial institutions, coupled with provisions to outlaw trusts from some offshore jurisdictions, would do the job, if imperfectly, in a far more cost-effective way.

It seems that opposition to trust beneficial ownership registration is not a matter of principle, but of costs and complexities. Here we present another view, especially since major international schemes are already starting to move in this direction.

This paper suggests various possible ways forward for discussion: such as making beneficial ownership and other trust-related information public; and outlawing (or treating as shams) trusts created in problematic jurisdictions such as the Cook Islands or Belize.

But we offer one proposal in particular: incorporation and registration of trusts as a precondition for their existence.

Trust incorporation: not even a revolutionary idea

Imagine a person writes on a piece of paper that he is King of The World and everything on earth belongs to him. He may believe it, but if he tries to use or dispose of anyone else's asset, the rightful owner can obviously use the law to rebuff the self-appointed King.

Yet for centuries people have been able to write on pieces of paper, in secret, creating trusts that determine titles to and restrictions on ownership ("now you will hold this asset in trust, for the benefit of this person") and the law generally accepts these pieces of paper – or, sometimes, just verbal agreements – as valid, often creating powerful legal shields between that person's assets and people not directly connected to the trust, such as their personal creditors or tax authorities. This is curious.

The heart of our proposal is that **if trusts are to be recognised by the law**, allowing them to do things like operating bank accounts, or owning property or shares, **they need to be registered and incorporated** with the appropriate authorities as a precondition for this legal recognition to happen.

Using more legalistic language, registration of trusts, and any other entity, should have "constitutive effect." This is a civil law concept meaning that the existence of the trust or entity starts with its proper incorporation or registration.²

² A less powerful version of this is "declarative effect" where the trust would still be valid and enforceable, but only among its related parties from the time of its creation, even if not registered. However, it would only be enforceable ("invokable") against an outside creditor or claimant such as a tax authority if it has been registered. In Argentina, for example, cars' registries have constitutive effect, while the real estate registry has declarative effects. This creates enormous incentives to register. If the buyer of the house does not register the purchase, the seller could sell the house again, and the new buyer could register it (and keep it). In principle, the first buyer might only have a claim against the seller (to get the money back, but even this would be difficult) but would have no claim against the new buyer (because the latter was not a party to the first purchase contract). In the case of cars, the incentive to register is even higher. According to the law, the owner of the car is whoever appears on the registry ("constitutive

This precondition is hardly unusual: companies, which may have similar effects to trusts in terms of separation of asset ownership, generally have to register and be incorporated in order to exist and operate³. Companies don't *exist* until they are 'incorporated' as companies. A well-established legal and institutional infrastructure already exists in most countries to register companies: commercial registries, for instance, play an important and useful role in global commerce. Trust registration would build on what already exists. If registries that work online, like the UK's Companies House, already offer information on shareholders, directors, accounts, etc. how hard would it be to offer similar information on trusts? Technology is now quite up to the job: the data storage demands, when compared to, say, holding online videos on the cloud, are negligible. The same could be said regarding the updating of beneficial ownership information. Current technology already allows for keeping track of the ownership of thousands of securities which are traded in financial transactions occurring even in less than a second.

Private Foundations have to register

Private foundations may be very similar to trusts in their function, ownership and control structures. They usually share common regulations, for instance via the OECD's Common Reporting Standard for automatic exchange of information. However, private foundations do have to register and incorporate in many countries.

A common criticism against trust registration is that trusts are not entities, but rather contracts or arrangements. However, it isn't the conceptual legal similarities between companies and trusts, but the practical risks of their effects and secrecy, that supports their registration. Moreover, there is a big difference between trusts and other types of contracts, such as a contract to paint a house (that no one is suggesting we should register), when it comes to the potential to affect third parties. Imagine a woman, whose only asset is a \$500,000 house, who borrowed \$1 million and hasn't paid the lender back. If the woman hires a painter to paint her house, that painting arrangement would be irrelevant for the lender, who would still be able to claim or "access" the house (the woman's only asset) as a way to get his money back. If instead the woman created⁴ a trust arrangement and the house is held by a trustee, that trust arrangement may hinder or even impede the lender's access to the house (to get his money back), because the woman would claim that the house is no longer hers. In other words, a trust, unlike a painting arrangement, can change the title to assets (e.g. the house), and thus affect the rights of third parties, such as creditors (the lender, in our example).

effect"). This is relevant because if anyone runs over someone with that car, the person appearing on the registry is liable, and merely showing a contract to sell the car is irrelevant.

⁴ If the trust was created years in advance and was carefully drafted, the lender would not be able to claim that the trust was created to defraud him, so it wouldn't be easy to invalidate the trust.

After all, no one is *obliged* to create a company or trust: if society is to grant the protection of the law to these creations that hold assets or engage in business, it is entitled to ask for something in return.

In fact, several fledgling international initiatives to register trusts already exist, as the next box explains.

This would arguably involve a fundamental change in centuries-old trust law, but we believe this is worth pushing for.

Making incorporation and registration a precondition for their legal existence would also transform the incentives of people using trusts. They could certainly still find ways to keep their trusts secret, but if this means their trusts aren't recognised by the courts it would be rather pointless to set one up. There would be no point *not* registering, in the same way that there would be no point *not* incorporating a company.

There would also be less need to get involved in 'herding cats' or creating an unworkable global information-sharing and regulatory maze to catch unwilling miscreants: people would *want* to register their trusts, rather than hide them.⁵

The alternative is to continue as we are currently doing, where registration is merely required as an administrative provision (usually with tax authorities) – and where a person may decide not to register it and hope not to be discovered (while still using and enjoying all the benefits and protections of the trust). In this case, we need to continue to trust financial institutions, real estate brokers, tax havens and other players in the international financial system to report honestly on trusts and to co-operate on sharing beneficial ownership information. However, there have been quite enough scandals to demonstrate that these players cannot be trusted with sole responsibility and that the system isn't working to ensure information will be available when needed.

Registration of Trusts already happening: EU and OECD

The **European Union's** Fourth Anti-Money Laundering (AML) Directive already requires that by 2017 all Member States register EU-linked trusts that generate tax consequences. A proposal by the EU Commission even proposes to amend the Directive to require registration of all trusts with a trustee resident in the EU and to give public access to basic information on the beneficial owners of trusts, including settlors, trustees, protectors, beneficiaries and classes of beneficiaries.

Also, over 100 jurisdictions have already signed up for the **OECD's Common Reporting Standard** (a scheme for sharing banking information across borders) which requires financial institutions to identify the beneficial owners of trusts: all settlors, protectors, beneficiaries or any person with effective control.

In some countries, trusts have tax identification numbers (and pay taxes at the trust level) and may then hold a bank account or house in the trust's name.

Problems and pitfalls: complexity and privacy

Trusts are complex structures that may involve settlors, protectors, enforcers, individual or corporate trustees, determined or determinable beneficiaries, classes of beneficiaries or “purposes” instead of beneficiaries. Some people, including a couple of reviewers of this paper, have said that because of the complexity and costs involved, it is not feasible to require the registration of trusts and associated players and instruments.

Some have also said that trusts involve private matters which should generally remain confidential. Millions of people – many of them not particularly wealthy – have interests in trusts, related to wills and other family matters.

Easier and “cheaper” solutions to some trust abuses include such proposals as these:

- Outlaw trusts from abusive offshore jurisdictions (e.g. the Cook Islands, Belize or BVI) that allow settlors and beneficiaries (instead of the trustee) to control the trust.
- Trusts should never be allowed to last indefinitely: like jurisdictions abolishing the rule against perpetuities now permit.
- Treat any trust that seeks to keep the trust document secret: that is, beyond the reach of tax and legal authorities and/or possible beneficiaries as invalid.

These are all potentially useful tools for tackling certain abuses of trusts. But, as suggested, we think it is possible to go further, with the requirement for registration of trusts and publication of some trust data. As mentioned, some global schemes are already going in this direction.

Overcoming the privacy objection for registration *and* publication

The privacy objection can essentially be dealt with in two main ways. The first is a generic argument; the second is a technique for legitimate limiting of disclosure.

Generic arguments

First, if it makes sense for companies to be *registered*, then there is no generic reason why trusts should not be. Scandal after scandal demonstrates trusts’ involvement in high crimes, so trust registration is an essential step for governments to take as they progress with efforts to bring transparency to the international financial system. And remember that nobody is obliged to set up a trust: if you want to obtain trust-based privileges and protections from society, then transparency is a minimal price to pay.

As regards *publication* of trust-related data, there is a strong public-interest justification for doing so. It is not only the tax havens and their private ‘enablers’ who can’t be trusted to provide the relevant information to those (tax authorities, criminal authorities etc.) with a legitimate need for it. Many governments whose tax coffers are being depleted by these activities *also* can’t be trusted to try and crack down: usually, because the élites who are

involved in the subterfuges are influential in government. This is a problem for rich and poor countries: Britain, for instance, has often been accused of turning a blind eye to offshore crimes, like when it failed to prosecute HSBC even after there was [“sufficient evidence for the bank to be investigated for conspiracy to defraud the UK tax authorities”](#). Even worse is when authorities themselves are involved in undeclared offshore affairs, like [Iceland’s Primer Minister forced to step down](#) after Panama Papers disclosed its offshore activities.

So registration alone clearly isn’t enough, if the governments entrusted with the data can’t be trusted to act in the best interests of their citizens. Accountability, and also helping authorities catch wrongdoers, requires access to ownership information by investigative journalists, NGOs and citizens and businesses that lose out. They need to hold not just the tax havens, but their own governments, to account. And that requires publication of data.

Preservation of some privacy

There is a **second** way to overcome the privacy objection, which is not an argument but a set of techniques. The general approach here is to limit the public disclosure to where it is needed, and preserve privacy where possible. This can happen in several ways.

One simple way to preserve privacy *could* be to apply a blanket exception for certain classes of people such as children or disabled people, or “family trusts”. But this is too problematic to work: what if the beneficiary of a trust is a child, but the settlor is a Mafia boss, and the assets originate from drug dealing and extortion? Should these assets be exempted? Clearly not. Or should a Ponzi fraudster be allowed to hide and protect her assets because she is in a wheelchair? Such a blanket exemption would be an open door for abuses (and an invitation for the world’s criminals to all obtain certificates of disability.) There is no type of trust where one could *a priori* determine that it won’t be involved in some crime or abuse.

But other approaches are possible.

For example, the European Commission currently has a proposal to amend its fourth AML Directive to provide public information on all of a trust’s beneficial owners – or in some cases only to those with a legitimate interest – which could be interpreted to include, say, investigative journalists or crime agencies.

Still another way to do this might be to have a blanket requirement for trust registration, and for publication of certain data – but with exceptions made on the basis of a court order.

Yet there is another, deeper approach that might be taken to manage the privacy objection.

Internal versus external

Some aspects of trusts only affect *internal* relationships between the various parties to the trust, such as where a trust effectively serves as a will, setting out who will inherit what on

the settlor's death. Other aspects, however, affect third parties outside the direct orbit of the trust: for example, trusts can be used to make assets impervious to third-party creditors, or to the tax authorities.

An approach here could be that privacy and the legality of the trust is preserved for those aspects of a trust that do not affect outside parties. But where the rights of wider society outside the trust are affected – it might involve a financial crime, or a legitimate creditor who is unable to reach assets held in a trust – then the right to privacy can no longer be invoked, and wider society should be provided with the information that affects it.

So for example, the trust could appoint a trustee to manage the settlor's cash or farmland. That would be a valid and enforceable service-provision contract, and the trustee could claim unpaid fees or anything that the trust deed allows. However, without registration neither the trustee, the settlor nor the beneficiary could invoke the trust to repeal a claim from a settlor's third-party creditor for unpaid debts, or the tax authorities. The trust would simply be a private arrangement only binding on the trust parties, but not on anyone else.

So: what should be registered, and published?

UK law on companies' beneficial owners (called "person with significant control") requires that, when a trust meets the criteria to be considered a beneficial owner of a company, such trust's trustee and any other person with effective control over the trust should be registered. This sounds complex because it means the authority registering the trust (or ensuring the accuracy of the registered information) would have to read and understand all trust documents to determine who has effective control. Instead, registering any related party (settlor, protector, trustee, beneficiary, etc.) mentioned in trust documents is simpler and faster.

In effect, all of the trust's component parts (settlers, protectors, enforcers, trustees, beneficiaries, classes of beneficiaries and any other person with effective control over the trust) should be registered. In fact, FATF Recommendations on anti-money laundering already require trustees to hold the updated identity of all these related persons of a trust, so this type of information already has to be produced and collected. Now, it could also be

registered. Second, all trust-related documents and instruments: the trust deed, letter of wishes, powers of attorney or administration. Third, assets and accounts.

Publication, to hold authorities to account and to help spot prevent crimes and anti-social behaviour would likely involve a subset of this information. This would involve basic information such as full name, country of residence and birth date/year of beneficial owners, and accounts or value of assets held, with some potential exceptions (e.g. minors) decided on a case by case basis.

Incorporation and registration in a commercial or civil registry would be better than simply registration with tax authorities, because the latter usually require registration when the trust (or its related parties) are subject to tax, but this does not cover trusts that could be involved in corruption or money laundering (where tax may not be owed). In addition, most tax authorities invoke fiscal secrecy to prevent sharing information with other agencies (such as the police) or the public.

Dealing with false information

The 'constitutive effect' provision would give people powerful incentives to file correct information and update it: failure to do so may invalidate the trust or render non-registered information without legal protection (e.g. appointing a new trustee). In addition, sanctions (such as prison sentences included in the UK law on beneficial ownership of companies) are necessary. Having the information in open data format would also help authorities cross-check the information against, say, tax returns, banking records, immigration records, residence, civil relationships, etc. Lying will remain possible, but it will be riskier.

How would this play out, internationally?

If it is a domestic law trust, with local assets and related persons, then this is a fairly straightforward proposition. On an international level, it gets a little more complex, since trusts, their related parties, and the assets they hold, are often sprinkled across many different jurisdictions.

It would be utopian, of course, to expect every country in the world to create a trusts registry and link it up into a seamless system of global information-sharing. Tax havens and financial 'enablers' would set out deliberately to thwart, undermine and sidestep any such moves, of course.

However, the essential principle we propose is that at least the authorities where the trust operates should have access to beneficial ownership information. So for example, if a foreign law trust (e.g. a UK trust) tries to operate in a different country (say Argentina) and open a bank account there or buy real estate, and the UK trust registry does not exist or does not publicly provide all this information, then Argentina should require such a UK trust to disclose its beneficial owners to local authorities (either via re-incorporation, re-registration or any process that gives authorities all the relevant data). Otherwise, the trust is deemed invalid.

Trusts that have not registered yet would not be able to operate locally. As explained above, private trusts could still exist and function, as long as they don't impinge on the rights of third parties outside the trust, such as creditors or tax authorities.

The system isn't infallible. A person in Argentina could create a trust in the Cook Islands and hold assets in Cayman. It may be impossible for Argentina (or any other country) to prevent this: it is up to each country to prevent entities and trusts operating in their territories from any wrongdoing.

Argentina could try to ban its residents from being involved in trusts from certain tax havens, or to require their disclosure to tax or other authorities. Enforcement would be hard, unless these residents want the trust to have any effect in Argentina (their country of residence). For instance, if an Argentine wants to include a foreign law trust in an inheritance procedure, or justify the purchase of real estate in Argentina with assets or distributions related to the foreign law trust, then these measures would grow teeth. In essence though, they would become enforceable because the trust is trying to operate in Argentina, not because Argentina is enforcing anything against a foreign trust not related to its territory.