

TRUSTS

Trusts are a powerful instrument of financial secrecy. Developed in medieval times to allow crusading knights to give their property to a trusted friend to look after, the modern trust has been widely abused by criminals, money launders and tax evaders as a means of hiding wealth. Trusts also commonly feature in tax avoidance schemes and the use of trusts to avoid inheritance tax is widely considered to be a major factor in the increasing inequality of wealth worldwide. This briefing sets out some proposals for how the law on trusts can be reformed to end many of these abusive practices.

The problem

The Swiss have secret bank accounts, others have trusts. Trusts are a legal instrument developed in the Anglo-Saxon world, although now available in many more countries. They have been widely abused to allow individuals to hide assets, evade and avoid taxes, and launder money.

A trust works as follows: An individual (the “settlor”) gives an asset to a trustee. The trustee, who is often a lawyer or a company holds and manages the asset for the benefit of a third person, the beneficiary.

Trusts originated in the Middle Ages and much of their positive image relates

to a nostalgic idea: a father unable to manage his own lands because he had to go fight a war, could leave all of his assets to a “trusted” person (the trustee) to take care of them in the benefit of his wife and children. Trusts are often defended as “private family matters” that allow a person to ensure their children and other vulnerable people will be taken care of.

However, nothing in trust law requires trusts to be used for family matters only. Beneficiaries need not be children or vulnerable at all. Some countries allow the original owner of the assets (the “settlor”) to also be one of - or the only- beneficiary. Settlers can also be, or at

least have full control of the trustee too. So why would anyone bother to create a trust? There are two main reasons:

Secrecy

It may be impossible to know that a trust exists, let alone who is behind it. Unlike companies and other entities, trusts do not need to be registered or incorporated for them to legally exist. An agreement written on napkin would be enough to create a trust. In addition, it may be very hard if not impossible to know who controls the trust.

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In the case of a company, it's pretty clear-cut who the owners are: the shareholders. In the case of a trust, there are no owners. Control may in practice be exercised by either the settlors, the trustees, the beneficiaries or even new



Abusive Trusts

In a financial arms race to invent ever more secretive financial products some jurisdictions have implemented particularly abusive trust laws.

These laws prevent trusts from following foreign court judgements, or blur even further the rules separating settlor, trustee and beneficiary.

We call trusts set up in these jurisdictions abusive trusts as many of these laws appear to be designed purely to service illicit or illegal activity.

Examples of such rules include self settled trusts, where the settlor is the only beneficiary

Flee clauses compel the trustee to move the trust to another jurisdiction if an event is triggered, say an investigation by a tax authority.

Duress clauses command the trustee to refrain from any action or instruction sent by the settlor, protector or beneficiary if the instruction was given under duress – such as a foreign court order. This duress clause helps shield the trustee from compliance with foreign laws.

There are mechanisms which allow the settlor to keep control of a trust. Revocable trusts for example allow a settlor to end a trust and regain control of an asset at any time.

A more detailed list of abusive trust laws can be found in the TJN report - Trusts, Weapons of Mass Injustice.

figures introduced in recent years such as protectors or enforcers. So, if a trust holds houses, luxury cars, yachts, or bank accounts, it may be impossible to know who really owns them. This can be abused by anyone to evade taxes, laundering money or hide proceeds of corruption, as it has been the case in many grand corruption cases involving former ministers, presidents and dictators from Guatemala, Chile, Pakistan, Nigeria, and Peru, or major tax evasion by millionaires from around the globe.

Asset protection

One way to understand the trust is to think of it as a promise to donate or gift something to someone in the future, by giving it to someone else to hold it in the meantime. The consequence of this is that no one “fully owns” the asset anymore (on paper), and it is in a type of “ownerless limbo” (in practice), unreachable by legitimate creditors of the settlor or beneficiaries, such as victims of accidents or fraud, tax authorities, etc.

The original owner of the asset (the settlor) can claim: “I no longer own the asset, I’ve given it to the trustee”. The trustee replies “I’m simply holding and managing the asset for the benefit of beneficiaries, it’s clearly not mine, I can’t do with it as I want”. However, beneficiaries also claim

to have no ownership “I will own the trust assets once they get distributed to me by the trustee, until then, I have nothing”. This lack of ownership by beneficiaries (on paper) can be strengthened by a special provision: the apparent “discretion” of the trustee. In “discretionary trusts”, the settlor, on paper, gives discretion to the trustee to decide when to give a distribution, how much, and importantly, to who. On paper, the trustee has discretion. In the case of discretionary trusts beneficiaries can say “Not only do I have to wait to own assets until I get a distribution, but I may end up not receiving anything at all, ever, if the trustee decides not to give me anything”.

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This way, trusts allow its users to keep using and enjoying assets held in the trust (e.g. a house), without having to give them up to authorities or creditors for any unpaid debt. Settlers and beneficiaries simply claim “sorry, we are not the owners of the trust assets”.

In addition, if a beneficiary doesn’t need to own the



trust asset to enjoy it, he/she need not bother “inheriting” it either, so no inheritance tax are triggered.

On top of everything, some countries have particularly pernicious provisions in their trust law, for example allowing clauses which require the trustee to ignore any foreign court order (for example, an order telling a beneficiary of a trust to pay their taxes)

Solutions

All of the people and assets connected to a trust (settlers, trustees, beneficiaries, protectors, etc.) should be registered with authorities (and accessible by the public) and registration should be a precondition of a trust’s legal existence, as it is with companies. Registration should take place in all jurisdictions where people connected to the trust reside, and assets are located. So for example if a trust was established in the United States, owns a house in France for the benefit of someone in Italy, the trust would need to be registered

in all three jurisdictions.

Abusive trust provisions in trust documents (e.g. non-recognition of foreign laws and judgements, the settlor being also the only beneficiary) should be prohibited.

This could be achieved by not allowing trusts to register if the trust contained one of a list of prohibited actions.

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If jurisdictions continue to allow trusts to be created which have abusive provisions in them, states should take countermeasures to protect themselves against such trusts. Countries should put together blacklists of jurisdictions that allow the formation of abusive trust structures. Inclusion on the

blacklist would mean that the trust had no legal status in the country implementing the blacklist. All persons involved in the trust, (e.g. the settlor, and trustees) could be held in contempt of court if a trust refused to abide by a court order or be penalised simply for being part of a blacklisted trust.

TJN also proposes that the asset protection trust, shielding trust assets from creditors and tax authorities should end.

If the settlor is in debt to someone but has no money to pay them back, trust assets that have not been distributed to beneficiaries yet should be considered as belonging to the settlor and reachable by his/her creditors, including tax authorities.

Further Reading

For a more detailed look at trusts and our proposals for reform of the trust system see Trusts: Weapons of Mass Injustice. Available from the TJN Website – <https://www.taxjustice.net/2017/02/13/trusts-weapons-mass-injustice-new-tax-justice-network-report/>

The paper attracted some criticism from trust practitioners in tax havens. We produced a response to those criticisms here: <https://www.taxjustice.net/2017/09/25/response-criticism-paper-trusts-weapons-mass-injustice/>

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Published by the Tax Justice Network, 38 Stanley Avenue, Chesham, Buckinghamshire HP5 2JG United Kingdom

email: Info@taxjustice.net

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