

COMMENTS AND RESPONSES OF ACTEC TO QUESTIONS POSED BY FATF  
ON DRAFT AMENDMENTS TO RECOMMENDATION 25  
AUGUST 1, 2022

[Sent via email to FATF.Publicconsultation@fatf-gafi.org.]

The American College of Trust and Estate Counsel ("ACTEC") is pleased to submit the following comments and responses to questions posed by FATF regarding proposed revisions of FATF Recommendation 25 entitled "Transparency and beneficial ownership of legal arrangements."

ACTEC is a professional organization of approximately 2,400 lawyers from throughout the United States. ACTEC also has approximately 60 International Fellows from many jurisdictions outside the United States. Fellows of ACTEC are elected to membership by their peers on the basis of professional reputation and ability in the fields of trusts and estates and on the basis of having made substantial contributions to those fields through lecturing, writing, teaching, and bar activities. Fellows of ACTEC have extensive experience in providing advice to taxpayers on matters of federal taxes, with a focus on estate, gift, and generation-skipping transfer tax planning, fiduciary income tax planning, and compliance. ACTEC offers technical comments about the law and its effective administration, but does not take positions on matters of policy or political objectives.

ACTEC commends the FATF for seeking comments from stakeholders, including designated non-financial businesses and professions (DNFBPs) to better meet its stated objective of preventing the misuse of legal arrangements for money laundering or terrorist financing. ACTEC has chosen to limit its comments to those questions posed by FATF with respect to the proposed revisions of Recommendation 25 that ACTEC believes are most closely related to the purposes and mission of ACTEC, and the situations in which ACTEC Fellows are most frequently involved with their clients.

***I. Scope of Legal Arrangements, risk assessment and foreign trusts***

*1. In this context, are the following concepts sufficiently clear? If not, how could they be improved?*

*a "governed under their law"*

*b "administered in the jurisdiction"*

*c "trustee residing in the jurisdiction"*

*d "similar legal arrangements" (as compared with express trust).*

In many instances the above concepts (at least items 1.a-c) will be sufficiently clear. If a settlor creates a trust, the trust instrument often specifically identifies the law that is intended to govern the trust, and if there is a single individual trustee who is domiciled in that jurisdiction, then it is sufficiently clear that the concepts "governed under their law," "administered in the jurisdiction" and "trustee residing in the jurisdiction" will all refer to the same jurisdiction.

We believe, however, that other situations may be more complicated. Assume that a settlor created the above trust 25 years ago. Since that time the settlor has passed away and there are two trustees serving. One trustee is an individual residing in a jurisdiction that is different from that of the settlor's. The other trustee is an institution incorporated in a different jurisdiction with a principal place of business in yet another jurisdiction, and has physical offices located in those and other jurisdictions. Assume further that there are multiple beneficiaries and that the trustees (the individual, as well as employees of the institution) interact with those beneficiaries, including by meeting with them in person, in several additional jurisdictions. There are also assets owned by the trustees that are in those (and other) jurisdictions, and various actions are taken by the trustees that could be considered "administration" in various locations. If R.25 is amended, it is possible that the trustees of this hypothetical trust could be considered subject to requirements based on many jurisdictions – as the "governed under their law" could refer to the law chosen by the settlor, but also laws of several of the jurisdictions that could possibly assert that other laws govern – whether by the residency of the trustees, or the location of various activities or other criteria which could be deemed to be where the trust is being administered.

We therefore suggest that if R.25 is amended so that countries "should apply measures to understand the risk posed by trusts and similar legal arrangements governed under their law or which are administered in their jurisdictions or whose trustees are residing in their jurisdictions" that the amendment should include language which would permit trustees to more readily determine which measures apply (in the case of conflicting measures) and which jurisdiction's regulations and standards are applicable. We also suggest that R.25 provide that the default law is that of the jurisdiction in which a court has the authority to exercise primary supervision over the administration of the trust, unless the trustee determines that another jurisdiction's law is applicable in certain circumstances, in which case the trustee would comply with the default law as well as the law of the other jurisdiction. In the United States the default law concept is found in the "court test" for the purpose of determining whether a trust is considered a "United States person" under United States tax law.

This approach would eliminate the possible challenge of a conflict between a law referenced in the trust instrument, the determination of "residence" (especially with multiple trustees) and mitigate the determination of where "administration" occurs.

## ***II. Obligations of trustees under R.25***

*4. What are the pros and cons of expanding the extent of information which trustees should hold to include the objects of power in the context of discretionary trusts? Is the concept of "objects of power" sufficiently clear and reasonable? Are there any other terms that you would recommend FATF use instead of "objects of power"?*

The benefits of expanding the definition of parties to a trust for purposes of a trustee's duty to obtain and hold adequate, accurate and update information to include "objects of power" would be to make available, when appropriate, as close to a full list of not only current and named future beneficiaries but also those who *may* benefit from the exercise of a power granted to a trustee, protector or beneficiary to direct the distribution of trust assets. The primary difficulty of this requirement is that in many instances it is impossible to identify the objects of a power

unless the beneficiaries are identified in the trust document. In addition, when an individual other than the trustee is granted a power of appointment, the trustee may not have any information about whether the power of appointment has been exercised until the triggering event occurs.

It would be reasonable to require the trustee to collect and retain information only about beneficiaries whose identity is ascertainable, including default beneficiaries if a power is not exercised at the time of the triggering event. Anything more would not only be unduly burdensome, but in many cases impossible. The requirement of maintaining and updating records would allow for future identifiable beneficiaries to be included as circumstances change and the power exercised.

The concept of "objects of power" would be best explained by including it as a defined term in the Recommendations. Its current reference in the Recommendations is related to only one of many ways where the identity of beneficiaries can be created or changed by use of powers granted in the trust document. We suggest a definition that includes the different types of powers used in different countries and jurisdictions, adding examples of the different types of powers granted to determine future beneficiaries of a trust, including general and limited (or special) powers of appointment, powers to determine beneficiaries given to trustees, advisors, or protectors, and any other manner of determining future beneficiaries either pursuant to the terms of the trust or applicable law.

*5. Do you agree with the proposed nexus of such obligations based on residence of trustee or location where the trusts are administered? Compared to the current obligation incumbent on countries that have trusts governed under their law, do you see pros and cons from such a change, (e.g., would there be a difference in terms of efforts to collect the information in cases where a trust may have trustees that are resident in more than one jurisdiction, and where a trust may be administered in a country in which a trustee is not resident)?*

As stated in our response to Question 1, the possibility for having more than one jurisdiction for the purpose of record keeping nexus would be a distinct possibility with different individuals and entities acting as trustees and administration occurring in one or more jurisdictions. If that is the case, is it appropriate for a trustee to have to deal with the record gathering and maintenance rules of two or more jurisdictions? Also, it seems possible that the actual rules promulgated by different jurisdictions would be somewhat different from each other, even if enacted pursuant to Recommendation 25. It is our opinion that a trust should only be required to comply with the record gathering rules of one jurisdiction. The issue then becomes how to determine *which* jurisdiction would control when more than one jurisdictions involved. One possibility is to establish a system of priorities to determine the applicable jurisdiction. Certain ordering rules could be established. However, we would recommend using the court jurisdiction standards set forth in the reply to Question 1 above as a more practical alternative.

*6. Do you see challenges in respect of record-keeping obligations for non-professional trustees noting that all other obligations under R. 25 apply to such trustees.*

Record keeping for non-professional trustees is always more difficult, without the systems and institutional knowledge of laws and trust administration a professional trustee holds. As in all matters of trust administration, an individual trustee would have to rely upon counsel and other advisers, but that is not applicable only to these new rules. We do recommend that if non-professional trustees are obligated to maintain the information for 5 years, they should only be required to maintain what that trustee had in their possession at the time they ceased serving.

The primary challenge that may be a larger obstacle for a non-professional trustee is whether that person would have sufficient influence with potential beneficiaries to obtain the required information from them, particularly if there are personal issues between the parties.

Recommendation 25 should perhaps provide a mechanism for a non-professional trustee to turn over the responsibility of maintaining records to a professional trustee or service provider so that there is a "safe" place for the records regardless of what happens to the non-professional trustee after ceasing to serve.

### ***III. Definition of Beneficial Owners***

*7. Would you support the insertion of a standalone definition for beneficial owner in the context of legal arrangements (distinct from that for legal persons)? Or would it risk creating confusion with the definition of beneficial owners applicable to legal persons? What relevance should control have in the definition of beneficial ownership of legal arrangement to address AML/CFT risk?*

While consideration of a standalone definition for beneficial ownership in this context is well-intentioned, ACTEC believes creating a separate definition for other legal arrangements, is unnecessary. Given the varying types of trustee/beneficiary relationships and degrees of control under each type of relationship, attempting to create a separate definition could risk creating ambiguity, unintended exceptions to the rule, or including a broader scope of individuals to which control is not a concern. In all situations, this may trigger over reporting and unnecessary administrative burdens. FATF should generally apply a consistent, uniform definition getting to the central requirement the rules are designed to address—control.

That said, understanding who are beneficial owners in the context of trusts is not always apparent when compared to more standard, contractual legal relationships. In a trustee/beneficiary arrangement, there may be different types relationships with varying degrees of rights. For example, those legal persons with "control" over the assets of a trust (i.e., the trustee) may not be the same legal person whose assets were contributed to create the trust and who retains certain powers over the trust property (i.e., the settlor or grantor). Further, the actual "beneficial interest" in trust property belongs solely to the current or vested beneficiaries named or described in the trust instrument, and even this relationship can sometimes be unclear.

But the different features of a trustee/beneficiary arrangement does not necessitate a separate definition of beneficial owner. Rather, a more in-depth analysis of the existing definition may be required in order to determine whether the sufficient level of control has been met. The existing definition already has interpretative guidance under the FATF Recommendations Glossary. For example, in the context of a trustee/beneficiary arrangement, the beneficial owner would be the trustee and any beneficiary in control of distributions (e.g., a mandatory income interest or

withdrawal right). However, if a beneficiary is merely a discretionary beneficiary, as in the case of an irrevocable discretionary trust, then under common law principles and applicable local law, such beneficiary would not be in control of the legal arrangement and should not be included as a beneficial owner in such an arrangement.

*8. Does limiting the information regarding beneficiaries to only those who have the power to revoke the arrangement or who otherwise have the right to demand or direct (that is, without the consent of the trustee) distribution of assets seem reasonable?*

In the narrow context of beneficiaries as beneficial owners, these limitations seem reasonable. On one end of the spectrum of a trustee/beneficiary relationship where a beneficiary only has a purely discretionary interest, there is no element of control with the beneficiary that FATF would seek to capture. However, on the other end of the spectrum where a beneficiary can revoke, alter, dispose of, or receive the trust property without the consent of a trustee, such a beneficiary is in control and should be reported as a beneficial owner.

Trustee/beneficiary relationships are not uniform among trust structures. It is in the less typical cases where the general definition of beneficial owner would need to be further analyzed. For example, in a legal relationship where a beneficiary must act together with another individual to exercise control over the trust property, it is possible that such individual would be included under the definition of beneficial owner. In the current landscape of trusts, it is not uncommon in discretionary trust relationships for other parties to have certain elements of decision-making or control (e.g. "investment advisors", "distribution advisors", "trust directors", and special trustees, among other titles). It is possible that any one of these parties would possess a sufficient amount of control to satisfy the definition of beneficial owner.

*9. Do you have any specific suggestions for a different standalone definition?*

Not applicable, based on ACTEC's recommendation to refrain from creating a separate definition.

#### ***V. Approach in collecting beneficial ownership information***

*Question 13. Can such an approach ensure that competent authorities have timely access to beneficial ownership information in the context of legal arrangements?*

In the context of legal arrangements between a trustee/beneficiary, ACTEC believes that the current requirements applicable to trustee reporting are appropriate to address AML concerns and the FATF principles. Additional legal requirements would be overly burdensome, redundant, significantly impair legitimate taxpayer privacy rights, divert from the general purposes for the creation of trusts (e.g. privacy, succession of family businesses, the protection and administration of assets for beneficiaries, the collective ownership of real property, the segregation and management of retirement plans, and varying types of charitable purposes) and arguably violate attorney/client confidentiality obligations.

FATF should also view the current requirements applicable to trustee reporting as sufficient to disclose beneficial owners, based on the following protections:

1. Trusts are monitored by trustees, many of whom are commercial banks and trust companies and are already fully subject to AML/CDD regulation.
2. Additional AML/CDD and FATF obligations arise at the level of retitling assets into the name of a trust upon the creation and funding of the trust.
3. Further reporting occurs at the level of taxing the trust and/or beneficiaries receiving distributions from trusts.
4. Hedge fund and private equity interests, which are commonly owned in trusts are also highly regulated industries that require issuers to conduct AML/CDD guided by FATF principles.
5. Other types of trust assets include real estate, art and antiquities, all of which are under increasing international AML regulation, also guided by FATF principles and local regulation. For example, in 2016 the United States, through its Financial Crimes Enforcement Network ("FinCEN") began issuing Geographic Targeting Orders ("GTOs") requiring title insurance companies to collect and report information about the persons involved in certain residential real estate transactions deemed to present AML risks.
6. Under the recently enacted US Corporate Transparency Act ("CTA"), a corporation, limited liability company, or other similar entity is required to report the beneficial owners thereof to FinCEN. Beneficial owners include individuals who directly or indirectly own or control not less than 25% of the ownership interests of the entity and persons who exercise substantial authority over the entity. If a trust owns an interest in such an entity, the company should be required by the CTA to report the above beneficial owner information with respect to the trust.
7. Beneficiary information is reported to competent authorities when beneficiaries receive distributions from trusts both under tax compliance laws and pursuant to FATCA/CRS reporting. For example, trustees of US domestic trusts must identify the beneficiaries to whom they distribute trust assets on the annual federal tax return that the trustee is required to file with the Internal Revenue Service (Form 1041). Trustees of a foreign grantor trust with an owner who is a United States person also must annually file IRS Form 3520-A, "Annual Information Return of Foreign Trust with a U.S. Owner." In addition, United States persons who receive distributions from a foreign trust, or who contribute assets to such a trust, must report such activity annually on IRS Form 3520.
8. The Uniform Trust Code ("UTC") and US states that have adopted it codify seminal trustee duties going back through the history of common law trusts, including the following:
  - a. The duty to administer the trust in good faith, in accordance with its terms and purposes and the interests of the beneficiaries;
  - b. The duty of loyalty to administer the trust solely in the interests of the beneficiaries;

c. The duty to act impartially in investing, managing, and distributing the trust property, giving due regard to the beneficiaries' respective interests; and

d. The duty to administer the trust as a prudent person would, by considering the purposes, terms, distributional requirements, and other circumstances of the trust.

It would be impossible for a trustee to carry out his or her legal obligations under these principles without providing the information to the current relevant authorities required under Recommendation 25.

*Question 14. Have you seen any issues/challenges with including information collected by other agents or service providers including trust and company service providers, investment advisors or managers, accountants, or lawyers as a mechanism?*

Yes, concerning service providers' duty to protect a client's privacy rights and ethical duties of confidentiality owed to clients. As applied to some professions, such as lawyers, disclosing confidential client information is subject to censure, suspension of the license to practice law, and potential disbarment. Other service providers, such as financial advisors and institutions, have similar obligations to the governmental agencies that regulate them. For example, the Investment Management Division of the Securities and Exchange Commission oversees registered investment companies as well as registered investment advisors. These entities are subject to extensive regulation under various federal securities laws.

*Question 15. Do you think that a multi-pronged approach should be followed for accessing beneficial ownership information of legal arrangements, consistent with Recommendation 24? Or would the features of legal arrangements make a single-pronged approach preferable instead? What are the pros and cons, including in relation to administrative burden, from these approaches?*

No, for the reasons stated in the response to Question 13. ACTEC believes the existing reporting requirements for trustees is adequate to address AML concerns and FATF principles

## ***VII. General questions***

*20. What are the potential issues/challenges for the public sector regarding implementation of the R.25 requirements?*

The primary goal that Recommendation 25 is designed to accomplish is to confirm that adequate, accurate and timely information is collected by the appropriate authorities on express trusts, including information on the settlor, trustee and beneficiaries and which can be utilized by the appropriate law enforcement authorities for the purpose of combatting money laundering and terrorist financing. Certainly trustees, financial institutions, DNFPBs, tax authorities, and other governmental authorities already have information of the various parties to a trust, such as the settlor, trustees, beneficiaries, etc.

One of the more significant challenges for the public sector regarding the implementation of this rule is that although all of the aforementioned parties have relevant and useful information that is sought by Recommendation 25, the context in which this information is provided would make it difficult for many of these parties to provide such information to the authorities. For example, as noted earlier, the attorney-client relationship in the US is considered confidential. This is necessary so that a client is able to be open and forthright with their attorney. Financial institutions also have in many contexts a legally enforceable confidential relationship and as a matter of course clients of financial institutions expect that the information provided will remain confidential.

Consequently, looking to parties other than trustees to help carry out the goals of Recommendation 25 is difficult and in many cases untenable. As outlined above, trustees already have reporting obligations pursuant to tax law and other statutes in the US, such as the newly enacted CTA, that put them in the best position to provide the information sought by FATF in Recommendation 25. In order to maintain consistency in reporting and to avoid weakening the legal and financial sectors, it would be best to focus on strengthening the existing reporting obligations of trustees in the context of Recommendation 25.

*21. Do you see any challenges in obtaining information regarding beneficial ownership information of legal arrangements when the trustee (or equivalent) resides in another jurisdiction or when the legal arrangement is administered abroad?*

Yes, trustees who reside in a jurisdiction other than that of the beneficiaries, or who administer the trust in a different jurisdiction, may very well confront situations where they cannot secure certain relevant information on beneficial ownership. However, in most circumstances the trustee will have a duty to comply with the governing law of the trust and do what they believe to be necessary to secure the required information.

If the trustee is in a position where the trustee cannot provide the required information due to the jurisdiction where the trustee resides or administers the trust there will be an obligation to take appropriate steps to ensure that the relevant information is provided. This may require adding an additional trustee in the local jurisdiction who can secure the information.

There are many situations where trustees are faced with unique issues and need to take tailored action to address such matters. Addressing the requirements of Recommendation 25 should not be any different. The overall requirements of the Recommendation 25 should therefore remain flexible so that trustees can decide on their own how to address unique situations and a reasonableness standard should be included so that trustees can accept and carry out their fiduciary duties within a practical scope of potential liability.

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In closing, the current mechanisms in place with respect to reporting beneficial ownership are more than sufficient to address FATF's money laundering and terror financing concerns. ACTEC recommends that the provisions of Recommendation 25 and its interpretations remain flexible so that trustees have the ability to address unique circumstances and can provide relevant and useful information to the appropriate authorities.

FATF's concerns should not drive over-regulation and a rights-based, rather than risk-based, AML approach. The more regulation that is put in place, the harder it will be for trustees and related fiduciaries to carry out their responsibilities and to comply with Recommendation 25 and related regulations.

Thank you again for this opportunity to respond to FATF's questions regarding Recommendation 25.

Respectfully submitted by on behalf of ACTEC by Task Force members Margaret van Houten, Raj A. Malviya, Ed M. Manigault, Carolyn A. Reers, Jack A. Terrill, II, Glenn G. Fox, and Lyat Eyal.