HM REVENUE AND CUSTOMS AND HM TREASURY CONSULTATION ON FIFTH MONEY LAUNDERING DIRECTIVE AND TRUST REGISTRATION SERVICE (THE "CONSULTATION")

RESPONSE OF THE COMPANY LAW COMMITTEE OF THE CITY OF LONDON LAW SOCIETY

By email to: Assets & Residence Policy Team
HM Revenue and Customs
Room 3C/03
100 Parliament Street
London
SW1A 2BQ

asres.consult@hmrc.gov.uk

Response date: 21 February 2020

Introduction

The views set out in this response have been prepared by the Company Law Committee (the "**Committee**") of the City of London Law Society (the "**CLLS**").

The CLLS represents approximately 17,000 City lawyers through individual and corporate membership, including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multijurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees.

The Committee is made up of senior and specialist corporate lawyers from the CLLS who have a particular focus on issues relating to company law and corporate governance.

We have responded below to the questions on which we have comments.

1. **Question 1 - Are there other express trusts that should be out of scope? Please provide examples and evidence of why they meet the criteria of being low risk for money laundering and terrorist financing purposes or supervised elsewhere.**

   (a) Trust arrangements incidental to a corporate transaction

   Trust arrangements frequently occur as an incidental part of a legitimate corporate transaction. Whilst such trusts may meet the criteria for being express trusts as set out in the consultation document and would therefore be registrable under the extended Trust Registration Service ("**TRS**"), they are not the primary purpose and are generally created to give better effect to the parties' commercial intentions.

   An example of this type of trust arrangement would be the customary provision in an agreement for the sale and purchase of a business which provides that, when dealing

with the apportionment of cash receipts between the seller's period of ownership and that of the buyer, if the buyer or seller receives monies that rightfully belong to the other, then it will hold such monies on trust for the rightful party until such time as they are paid over to that party.

The benefit of using the trust structure is that, pending payment to the rightful owner, it removes the property from the holder's estate such that it cannot be used to satisfy the holder's creditors or form part of its estate on an insolvency. It also ensures that the receipt is taxed in the hands of the party beneficially entitled to it. It is therefore preferable to simply having an express obligation to pay monies over – it also frequently being the case that monies are paid over in tranches which necessitate them being held by one party for some time pending the payment date.

If not created expressly, a trust may also be implied in the circumstances. While this would mean it would not be registrable (paragraph 3.3 of the Consultation), such uncertainty would not be welcome or advisable, particularly on high value transactions. The certainty which the creation of express trusts provides significantly reduces the likelihood of disputes that would otherwise arise concerning the creation (or not) of implied trusts.

The Appendix sets out other examples of ancillary trust arrangements in the context of corporate transactions.

The list illustrates the variety of ways in which express trust arrangements are used in legitimate corporate transactions. Even then, the list is not exhaustive. Given the number of corporate transactions that are undertaken each year, and the number of documents involved in each, it is likely that there would be a very great number of trust arrangements that would meet the criteria for registration.

Given the ancillary nature of these arrangements, we feel that this would entail a disproportionate burden on parties to a transaction and their advisers. Moreover, we do not consider that these are the types of arrangement that are intended to be caught. With such a high potential number of registrations it would also mean that the register itself could be hard to maintain and/or search effectively. It would also increase the cost of contracting.

It is also worth noting that many of the trust arrangements referred to would be mutual. In the business sale example given above, the buyer would be under a duty to hold monies belonging to the seller on trust for the seller. The seller would then be under a reciprocal duty in favour of the buyer. This is likely to give rise to a practical issue regarding the registration of such arrangements. Should one or other party register the arrangement? Or should both parties do so? If both are to do so, this would significantly increase the number of registrations which, as noted above, might already be considerable in volume. Moreover, in many corporate deals there are more than two parties which may further increase the number of potential registrations.

We are also aware that similar types of ancillary trust arrangements occur in other fields of law, especially financial law. We understand that the Financial Law Committee of the CLLS has raised these previously with HMRC and HMT which led to the

inclusion of the exemption at 45ZA(1)(f) of the draft Regulations in Appendix A of the Consultation.

We believe that a similar exemption should be included to cover the types of trust arrangements outlined above in corporate transactions. As these are incidental to legitimate corporate deals we believe such trusts to be low risk for money laundering and terrorist financing purposes. This is even more so where the parties to the transaction are being advised by a solicitor or law firm regulated by the Law Society and which has (a) carried out due diligence in respect of its client and (b) is subject to duties to report concerns relating to proceeds of crime.

In the context of company law, the prohibition on the giving of financial assistance in connection with an acquisition of shares does not apply where *"the company's principal purpose in giving the assistance is not to give it for the purpose of any such acquisition, or the giving of the assistance for that purpose is only an incidental part of some larger purpose of the company, and the assistance is given in good faith in the interests of the company"* (s678(2)(b) Companies Act 2006). This recognises that there are ways in which financial assistance can be given that do not constitute mischief of the kind that the prohibition is intended to prevent. Similarly, express trusts provide a neat conceptual bridge between the law of contract and the law of property and are a powerful contracting tool in English law. To presume that all of them could be used for purposes of money laundering or terrorist financing is to fail to recognise how useful and ubiquitous they are as a feature of English corporate and commercial law.

As the nature and/or structure of the overall (or primary) corporate transaction gives rise to the need for these incidental type trusts as well as identifying the property itself which is the subject of it and how that property is to be handled, we consider that there is limited risk of the beneficiaries manipulating it for money laundering or terrorist financing purposes.

(b) Type B trusts

We note that, as currently drafted, under proposed Regulation 45ZA, a type B trust is not able to avail itself of any exemptions in proposed 45ZA(2) in the same way that a type A trust can. We do not see why this should be the case.

If, on a corporate deal, there was a non-UK party to the transaction who met the criteria for being a type B trust (for example, by instructing a UK solicitor), it would seem odd if they were subject to requirements to register when a party who was a type A trust was not subject to the same duty. If exemptions for incidental trust arrangements as described above are included in Regulation 45ZA(2) as we suggest, this would mean that an incidental trust arrangement which would be exempted in respect of a type A trust, could in itself mean that a non-UK party could become a type B trust if the criteria in Regulation 45ZA(1)(b) are met, so that it would need to register details of that trust (which a type A trust would not have to).

We therefore think that the exemptions in draft Regulation 45ZA(2) should extend to type B trusts as well as type A trusts.

(c) Third country entities

If exemptions for incidental trust arrangements are not included in Regulation 45ZA(2) as suggested above, this would result in a potentially large number of corporate bodies who are parties to corporate transactions being type A or type B trusts. As a result, they would then be required to disclose details of third country entities under proposed Regulation 45ZA(5). In large groups of companies, this could result in a high volume of disclosure in respect of group companies and investments. This would seem disproportionate to us in light of the fact that the trust arrangements, as noted above, are incidental to the corporate transaction in question and low risk as a result. We would also consider that the fact that it would give rise to this effect supports the idea that the proportionate approach would be to exclude such incidental arrangements from being classed as type A or type B trusts.

(d) Ownership of shares

Significant beneficial holdings of shares have to be disclosed under the People with Significant Control regime ("**PSC**") or the Disclosure Guidance and Transparency Rules "(**DTRs**").

We note that in paragraph 9.15 of the consultation which preceded this Consultation, it was stated that the government is considering whether there are other registration services already in existence for particular types of trust to avoid duplicate registration wherever possible. We consider that share ownership is one such instance. For this reason, we believe that beneficial ownership of shares should be outside the scope of the TRS.

We appreciate that this would only catch holdings of a certain size but are of the view that, when the PSC and DTR limits were set, issues of risk and proportionality would have been considered and the thresholds decided on the basis of their being reasonable in the circumstances. In terms of the TRS, we would therefore consider that holdings below the thresholds set for the PSC and DTRs should not be of concern.

2. Question 2 – Do the proposed definitions and descriptions give enough clarity on those trusts not required to register? What additional areas would you expect to see covered in guidance?

(a) Approved share option schemes/trusts established to meet statutory conditions

Paragraph 3.14 of the Consultation suggests that approved share option and profit-sharing schemes should be outside the scope of the TRS. We agree with this approach but, are not sure which provision of the draft Regulations at Appendix A of the Consultation is intended to catch it. We presume it is meant to fall under draft Regulation 45ZA(2)(a) but do not feel the wording of that Regulation entirely covers the types of arrangement discussed at paragraph 3.14 which includes trusts established to meet the conditions of a statute rather than simply being required or imposed by that statute.

We therefore think the wording of draft Regulation 45ZA(2)(a) could be clarified to make it clear that, if that is the intention, it includes the types of trust mentioned at paragraph 3.14 of the Consultation. If it is not the intention that such trusts are covered by that draft Regulation, clear exclusions should be added to draft Regulation 45ZA(2) to cover the types of situation described in paragraph 3.14.

(b) Trusts created by, or in order to satisfy, the terms of an order of court or a tribunal

We agree with the inclusion of an exemption for trusts which are created by, or in order to satisfy, the terms of an order of court or a tribunal. However, we think there are related matters, such as undertakings given to the court, which should also be caught but which, on the present wording of draft Regulation 45ZA(2)(b), are not. We therefore think the wording should be widened to include such undertakings.

Examples of where such undertakings may arise in a corporate context are:

(i) on a takeover effected by way of scheme – an undertaking given by the bidder to the court to set aside consideration which is payable to untraceable or missing shareholders; and

(ii) on a share capital reduction confirmed by the court – an undertaking given by the company to the court to set aside an amount of money in a blocked account for the benefit of creditors or otherwise for creditor protection purposes.

3. Question 3 – Do the proposed registration deadlines and penalty regime have any unintended consequences that would lead to unfair outcomes for specific groups?

Trust arrangements incidental to a corporate transaction

Our answer to Question 1 above explains the background to trust arrangements which are incidental to corporate transactions. As these are ancillary arrangements they do not usually specify a duration.

As noted above, corporate transactions could include a large number of incidental trust arrangements. In terms of complying with the deadline for registration, the need to register arrangements that exist as at 10 March 2020 could be an onerous obligation as there could be a high number of arrangements in transactions which pre-date that date and need to be registered. The task of identifying the relevant provisions could also be unduly onerous, time consuming and costly and we would query whether this effort would be proportionate.

Appendix

Examples of trust arrangements which are incidental to corporate transactions

1. Private M&A

(a) Business sale agreement – benefit of contracts held on trust by seller pending assignment to buyer

(b) Business sale agreement – receipts of cash by one party which relate to the other's period of ownership held on trust pending payment to that other party

(c) Business sale agreement – receivables collected in by buyer held on trust for seller

(d) Share and business sales - consideration monies held in escrow/retention account, for example, pending expiry of warranty period

(e) Share and business sales – 'wrong pockets' provisions assigning ownership of assets held by one party but rightfully belonging to the other

(f) Items (a) to (e) could also be relevant on the sale of a particular asset or assets (as opposed to a business as a going concern)

(g) Share sales - power of attorney to secure an interest in shares – shares held on trust for buyer pending the register of members being written up – legal title to the shares not having transferred until that has been done

(h) Share sales – sale proceeds of shares or loan notes held on trust for minority investors subject to 'drag along' rights

(i) Share sales – declarations of trust used when legal title to shares needs to transfer immediately, for example, where successive transfers of shares need to occur one after the other (the usual sale process relies on legal title transferring when the register of members is written up which can only be done once the stock transfer form transferring title has been stamped which creates a delay) – such arrangements are often used on group reorganisations where transfers of shares happen in quick succession

(j) Transfer of interest in a limited partnership – the outgoing partner holds money or property on trust for the incoming partner where that money or property relates to the new partner's period of membership rather than its own

(k) Private equity investments – rights afforded to an investor expressed to be held on trust for its affiliates

2. Corporate/commercial

(a) Unclaimed dividends – held on trust by the company pending shareholder identification/location

(b) Agent and trustee arrangements used to confer benefits on persons who are not a party to the contract in question as a preferred alternative to the Contracts (Rights of Third Parties) Act 1999

3. Equity raisings

(a) Rights issue or open offer - company may sell shares allotted to a shareholder when payment for the shares is not received or is treated as invalid - proceeds of sale held on trust for relevant shareholder

(b) Rights issue – when a receiving agent needs to verify identity of a person lodging a provisional allotment letter, the company may sell the ordinary shares as part of the rights issue and hold the proceeds of sale on trust where the acceptance proves invalid

(c) Rights issue - where shareholders do not (or cannot) take up their rights and the underwriter sells shares in the market at a price in excess of the rights issue price, the excess is held on trust for such non-accepting shareholders

(d) IPO – certain shares sold as part of the IPO are held in trust by a CREST nominee first on behalf of the seller and then on behalf of the buyer pending the shares being dematerialised

(e) Financial advisers - broad indemnities are always given in favour of investment banks and are sometimes referenced as being given to the relevant party for itself and as trustee for its affiliates