

COMMENTS AND RESPONSES OF ACTEC
TO QUESTIONS POSED BY FATF
ON DRAFT AMENDMENTS TO RECOMMENDATION 25
TO BE CONSIDERED AT THE FEBRUARY 2023 FATF MEETINGS
DECEMBER 6, 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 and its Interpretive Note to be considered during the February 2023 FATF meetings.

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 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.

In particular, the FATF seeks comments on the following questions with respect to the proposed changes to Recommendation 25 and its Interpretive Note:

1. Are FATF proposals adequate to mitigate the risk of misuse of legal arrangements and to ensure access to BO information?
2. Are proposals clear and are there any issues which need further clarification or that should be addressed in guidance?
3. What is the expected impact of the proposals on legitimate activity? In particular, what are the challenges for implementation?

ACTEC focuses on three specific issues in these comments, all of which relate to one or more of the above questions.

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Issue 1: The beneficial ownership information required to be collected and made accessible to competent authorities under Recommendation 25 and Interpretive Note 1 should relate only to those beneficial owners who have some degree of control.

With respect to beneficial ownership information, the goal of Recommendation 25 and Interpretive Note 1 is, and should be, for countries to collect information of those beneficiaries who have some degree of control over a trust or other similar arrangement. Persons who may misuse the arrangement for money laundering, terrorist financing, internet fraud, cyber-crimes, drug trafficking, weapons smuggling, etc. are those in control of the arrangement.

Control is at the heart of Recommendation 25. The last sentence states that "[c]ountries should consider facilitating access to *beneficial ownership and control* information." (Emphasis added.) Moreover, the FATF Recommendations' glossary definition of the term "beneficial owner" provides that ". . . beneficial owner refers to the natural person(s) *who ultimately owns or controls* a customer and/or the natural person on whose behalf a transaction is being conducted. It also includes those natural persons *who exercise ultimate effective control* over a legal person." (Emphasis added.)

The edited language of Interpretive Note 1 may lead to a conclusion that information on beneficial owners who are not in control of a trust or similar legal arrangement, such as purely discretionary beneficiaries who cannot access trust assets without a trustee taking action, should be reported. For example, prior to the current proposed changes, Interpretive Note 1 stated that information to be collected should include that of a ". . . beneficiary or class of beneficiaries and any other natural person exercising ultimate effective control over the trust." This made it clear that the focus was on those in control. The proposal appears to broaden the information to be collected to include "each beneficiary."

Collecting and reporting information on each beneficiary of the trust, regardless of whether they have any degree of control over the arrangement, will put a significant burden on authorities in each country who are tasked with collecting such information. Collecting information on beneficial owners who have no control over the arrangement will not mitigate the risk of misuse of legal arrangement.

The US has taken the approach of focusing on beneficiaries with some degree of control in a number of regulations with similar goals to those of Recommendation 25. For example, 31 CFR § 1010.350(e)(2)(iv), which regulates who must file a Foreign Bank Account Report (Form TD–F 90–22.1), provides that a US person has a financial interest in a foreign bank account if the account is held by a trust in which the US person either has a present beneficial interest in more than 50% of the assets or from which such person receives more than 50% of the current income. Likewise, 26 CFR §1.6038D-5(f)(2)(i), which addresses whether a person has reached the reporting threshold for specified foreign financial assets on IRS Form 8938, provides that the value of the person's interest in a foreign trust is the value of the assets distributed from the trust to the beneficiary, plus the value of the beneficiary's right to receive mandatory trust distributions. Finally, 31 CFR section 1010.380(d)(2)(ii)(C)(2), which regulates the recently enacted Corporate Transparency Act, includes as a beneficial owner of a reporting company owned by a trust only those beneficiaries who have rights similar to those in the below recommendation of ACTEC.

Therefore, ACTEC recommends that Recommendation 25, Interpretive Note 1, and the glossary definition of "beneficial owner" clearly state that these provisions relate only to those beneficiaries of a trust or other arrangement who are the sole permissible recipient of income and principal from the trust or have the right to demand a distribution of substantially all of the trust assets. This will focus the collection of beneficial owner information on those who can access the funds for money laundering, terrorist financing, internet fraud, cyber-crimes, drug trafficking, weapons smuggling, and other like criminal activity.

Issue 2: FATF should provide a clear definition of the term "object of a power" in Footnote 2 of Interpretive Note 1 and confirm that this term relates to the discretionary powers of a trustee.

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 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.

Before addressing additional specific comments relating to the "object of a power", it is important to first highlight the general fiduciary/beneficiary relationship in the trust context. A trust is a legal arrangement whereby an person (the settlor or grantor) transfers property to another person (the trustee) so the property can be held and administered for the benefit of a third party (one or more beneficiaries). This bifurcation of ownership principle between legal title to and equitable interests in trust assets is a hallmark characteristic of the common law of trusts.

Within the trust legal relationship beneficiaries are either contingent beneficiaries or vested beneficiaries (sometimes also called non-contingent beneficiaries). A contingent beneficiary may never receive a distribution of trust property. A contingent beneficiary only receives trust property if the vested beneficiary fails (e.g., if a vested income beneficiary dies before the termination of the trust). A contingent beneficiary possesses no current ownership rights in the trust property. A vested beneficiary is entitled to receive trust property, either currently or sometime in the future. The vested beneficiary possesses an enforceable equitable ownership interest in trust property.

Identifying a fiduciary of a trust (e.g. a trustee) is a fairly straightforward exercise in many cases. Identifying a beneficiary of a trust—whether contingent or vested—is equally straightforward.

Notwithstanding the above, an "object of a power" as contained in Footnote 2 is not a term utilized in the trustee/beneficiary context. Certainly, settlors of trust agreements may create what is called a "power of appointment" in favor of another. A power of appointment is a right which one person (the donor) confers upon another (the donee) in a trust (or other type of estate planning instrument such as a will) to designate those who are to receive principal or income of the trust (or of the donor's estate in the case of a will) after the donor or the donee dies or after occurrence of some

other event. Generally speaking, a power of appointment is granted to individuals (often beneficiaries) in their personal capacity. Trustees acting in their fiduciary capacity are not generally granted a power of appointment.

With the above background on powers of appointment, one can see how an “object of a power” is not workable in the beneficial owner context. Using this term would essentially make beneficial ownership reporting in the trust context impossible because the holder of a power of appointment could exercise the power to an extremely large number of people, possibly anyone in the world. Moreover, the timing of the holder’s exercise of the power may not be ascertained until many years after the trust is created.

For the above reasons, ACTEC strongly encourages a definition that includes the different types of powers used in different countries and jurisdictions as noted above.

Issue 3: FATF should revise the phrasing of Footnote 4 of Interpretive Note 1 to clarify that sufficiency tests would not include situations where a trustee has significant real estate/other local investment in the country that his owned by the trustee in the trustee's personal capacity (as opposed to real estate/other local investment that the trustee holds in its fiduciary capacity on behalf of the trust, which should be part of the sufficiency tests).

The text in the report at Footnote 4 states that countries should assess the money laundering and terrorist financing risks associated with types of foreign legal arrangements that have "sufficient links" with their country and take appropriate steps to manage and mitigate the risks. Footnote 4 itself states that an example of a sufficiency test may include when a trustee has significant real estate/other local investment, or is a tax resident, in the country.

It is not clear whether a trustee’s personal assets in a country would be considered when determining whether a trust has sufficient links to that country. It is possible under the current language that a trust with insignificant or no assets in a country could become subject to that country’s scrutiny merely as a result of the trustee’s personal ownership of assets in that country.

We suggest that the wording of Footnote 4 be clarified to specifically state that the sufficiency tests would only apply to assets owned by the trust (or the trustee in its fiduciary capacity) and would not include any consideration of assets owned by the trustee individually or in his or her personal capacity.

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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, Glenn G. Fox, and Lyat Eyal.