Wealth and trusts quarterly digest

November 2017

Welcome to our latest Wealth and trusts digest. Our quarterly digest provides up to date commentary and analysis on key sector developments. It is written by members of our wealth and trusts team to assist you and your clients in responding to market trends and legal developments. We would welcome the opportunity to discuss any issues you may have and always welcome feedback on the content of our publications.

Feature

The 2017 Money Laundering Regulations: how do they affect trustees?

Trustees may now have obligations to ensure that their trust is registered and to provide information about both the trust and its beneficial owners on an ongoing basis, as well as having more general obligations to comply with regulations following the implementation of the 2017 Money Laundering Regulations (the Regulations), which came into force on 26 June 2017. more›

News

Amendments made to the Offshore Asset Moves Penalty (Specified Territories) Regulations 2015

Two amendments to the Offshore Asset Moves Penalty (Specified Territories) Regulations 2015 came into force on 3 November 2017; the introduction of an additional penalty and a change in the specified territories. more›

HMRC opens trusts register to agents and confirms extended deadline of 5 January 2018

HMRC has confirmed that the Trusts Registration Service (TRS) is now available to agents filing on behalf of trustees. more›

Fundraising Regulator issues new rulebook for private site fundraising

The Fundraising Regulator has issued a new rulebook for private site fundraising as part of wider changes introduced to standards for face-to-face fundraisers. more›

Case reports

Ann Legg and another v Aaron Burton and others

The High Court has held that mutual wills can be upheld on the basis of evidence of an express agreement between the testators of their intention to create mutual wills. more›

Any comments or queries?

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JSC Mezhdunarodniy Promyshlenniy Bank & Anor v Pugachev & Ors

The High Court has held that a settlor of five discretionary trusts was the true owner of the trust assets. more›

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In a dispute concerning a failed securitisation transaction, the High Court considered whether a note trustee was entitled to meet certain legal and financial expenses of the noteholders. more›

Feature

The 2017 Money Laundering Regulations: how do they affect trustees?

Trustees may now have obligations to ensure that their trust is registered and to provide information about both the trust and its beneficial owners on an ongoing basis, as well as having more general obligations to comply with regulations following the implementation of the 2017 Money Laundering Regulations (the Regulations)[1], which came into force on 26 June 2017.

By way of background, the Regulations implement the Fourth Money Laundering Directive (2015/849/EU)[2] which is aimed at further combating money laundering, terrorism financing and organised crime.[3] One of the ways that the legislation seeks to do this is through increasing the transparency of trust structures via the creation of trust registers in European Union member states. Such a register will be overseen by HMRC in the UK and will include information about the trust and its beneficial owners, making it more difficult for criminals to hide behind trust structures. Crucially, failure to comply with these obligations can result in criminal, as well as civil, sanctions (including prison sentences). However, exactly how the provisions will be enforced in practice is far from clear and this is likely only to become clear over time as issues arise and are dealt with in further guidance published by HMRC.

Who will the regulations apply to?

The trust register provisions only apply to "relevant" trusts. A relevant trust is either:

- a UK trust that is an express trust; or
- a non-UK trust that receives income from a UK source or has UK assets, and UK tax consequences (ie it receives income in the UK or has assets in the UK that are subject to UK tax).

Whilst this seems relatively straightforward, the position can become complex where company structures are themselves complicated. HMRC has yet to provide further guidance for specific scenarios. For example, in circumstances where a trust holds assets through a foreign company, it would appear that the trust does not have to register as no UK tax liability would apply but this has not been confirmed by HMRC.

Registration

Registration is through an online portal and must be completed by all trusts to which the Regulations apply. HMRC guidance indicates that new trusts must be registered by 5 October of the tax year in which they are set-up. The same online portal will also need to be used for filing statements of accounts and adding information about the trust or its beneficial owners.

Record keeping

Two categories of information will need to be collected: (i) information about the trust; and (ii) information about beneficial owners (including potential beneficiaries)[4]. It is the trustees who are obliged to collect and maintain these records.

As regards the trust, the following information must be collected and maintained:

- **general information** – the name, date of establishment of the trust, the country in which the trust is tax resident, where it is administered and contact addresses for the trustees

1. Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (SI 2017/692).
2. Fourth Money Laundering Directive (2015/849/EU).
3. See the recitals of the Fourth Money Laundering Directive (2015/849/EU).
4. Beneficial owners include the settlor, the trustees, the beneficiaries and any other person who has control over the trust – see paragraph 6(1) of the Regulations.

- **statement of accounts** – this should describe the assets of the trust and the value of each category of assets, as well as providing the addresses of any property held by the trust
- **other advisors** – a list of the full names of any advisors who are being paid to provide advice to the trustees in relation to the trust (eg legal, financial or tax advice).

The following information about beneficial owners who are individuals is required:

- full name
- date of birth
- national insurance number or unique taxpayer reference (or if the person does not have these, their UK residential address or other identifier in substitute in accordance with regulation 45(6) of the Regulations)
- role (in relation to the trust).

The following information about beneficial owners who are not individuals is required:

- full name
- unique taxpayer reference
- registered office
- legal form of the entity and the law by which it is governed
- name of register of companies in which it is registered and registration number (if applicable)
- role (in relation to the trust).

A point to note is that where there is a class of beneficiaries, trustees do not need to ascertain who any unknown beneficiaries are, instead it is sufficient for them to provide a description of the class.

Trustees must retain these records for a period of five years after the date on which the final distribution is made under the trust and then make arrangements for them to be deleted (unless certain circumstances apply, eg there are ongoing court proceedings which are utilising the documents).

Provision of information

Trustees will generally have to provide information about the trust, or its beneficial owners, to three categories of third party: (i) HMRC; (ii) law enforcement authorities; and (iii) "relevant persons"[5].

- **HMRC** – information must be provided on an annual basis to HMRC via the online portal. HMRC has indicated that for trusts that had a UK tax consequence in the 2016/17 tax year, information must be provided by 31 January 2018. Information must be updated by 31 January every year (as long as the trust continues to be a "relevant" trust). However, as the Regulations came into force midway through the year, the applicable date for trusts that are in existence after the Regulations came into force but do not incur UK tax liability until the 2017/18 tax year is uncertain. HMRC has yet to give guidance on this.
- **Law enforcement authorities** – information on the beneficial owners of the trust must be provided to law enforcement authorities (eg the Serious Fraud Office, the National Crime Agency etc.) within any reasonable period specified.
- **Relevant transactions or business relationships** – trustees also have an obligation to disclose their status as trustees when they enter into a relevant transaction with a relevant person or form a business relationship with a relevant person. The relevant person can

5. See the definition in the Regulations.

also request identifying information for all beneficial owners of the trust. Where a business relationship continues, a trustee must notify the relevant person of any change to its status as a trustee or of the identifying information for beneficial owners and the date on which the change occurred, within 14 days of becoming aware of the change.

Disclosure and confidentiality

The Regulations contain provisions designed to protect trustees from inadvertently flouting any disclosure restrictions to which they are subject when providing the requisite third parties with information and are acting in good faith. However, such disclosure may present cross-border difficulties for some trustees, as it remains to be seen how this sharing of information will impact on any confidentiality agreements a trustee may be party to in other jurisdictions (particularly jurisdictions outside the European Union).

Next steps

The next iteration of the Money Laundering Directive (the Fifth Money Laundering Directive) is currently still under discussion at European Union level and its eventual implementation may affect trustees. For example, proposals to make the trusts register public (and not just viewable by certain authorities) are currently being considered. If this was to occur it may affect the way trusts are viewed and utilised. However, given the uncertainty around the UK's Brexit arrangements, it is unclear whether this will become law in England in Wales.

Back to contents>

News

Amendments made to the Offshore Asset Moves Penalty (Specified Territories) Regulations 2015

Two amendments to the Offshore Asset Moves Penalty (Specified Territories) Regulations 2015 came into force on 3 November 2017; the introduction of an additional penalty and a change in the specified territories.

The Regulations, which specify territories for the purpose of determining whether a "relevant offshore asset move" (ROAM) has occurred, have been amended as follows:

- an aggravated penalty at a rate of 50% of the original penalty has been introduced for taxpayers who are i) liable for offshore penalties for deliberate failure in respect of income tax, corporation gains tax or inheritance tax; ii) have moved assets on or after 27 March 2015 from a specified to a non-specified territory within the relevant time period; and iii) the main purpose for moving or transferring the assets is to prevent or delay HMRC discovering potential tax due
- specified territories have been amended to reflect committed jurisdictions to exchanging information under the Common Reporting Standard
- countries removed from the Regulations as specified territories are Albania and the USA
- countries incorporated into the Regulations as specified territories are Bahrain, the Cook Islands, Ghana, Kuwait, Lebanon, Nauru, Panama and Vanuatu.

A copy of the amendments are available to view here.

Back to contents>

HMRC opens trusts register to agents and confirms extended deadline of 5 January 2018

HMRC has confirmed that the Trusts Registration Service (TRS) is now available to agents filing on behalf of trustees. HMRC has also confirmed that no penalty will be imposed where registration is completed after 5 October 2017 but before the extended deadline of 5 January 2018. HMRC has made it clear that this extended deadline is a "one-off" extension for the first year only and that the deadline for all future years will be 5 October.

Trusts Registration Service

The TRS will be a single point of access for trustees and personal representatives (PRs) of complex estates to comply with their registration and reporting obligations.

HMRC has asked that trustees and PRs delay notifying it of a new trust or complex estate until the register is operational. Introducing a central trusts register will implement the requirements of Article 31 of the Fourth Money Laundering Directive.

Implications for trustees

The register will take over the function of the paper trust registration Form 41G (Trust), which will no longer be accepted.

All trusts with a UK tax consequence must be registered, including trusts that have already been registered using Form 41G (Trust), unless the trustees, or their agent, have received written confirmation from HMRC that the trust has ended.

Trustees must also update the register each year that the trust generates a UK tax consequence and confirm its accuracy.

As well as details of the trust assets, trustees must provide information regarding the identity of the settlor, trustees, protector (if any), all other persons exercising effective control over the trust (if any) and the beneficiaries or class of beneficiaries.

Implications for PRs
All complex estates must be registered, including estates that have already been registered with HMRC, unless the PRs, or their agent, have received written confirmation from HMRC that the administration period has ended.

An estate is complex if:

- the value of the estate exceeds £2.5m
- tax due for the whole administration period exceeds £10k
- the value of assets sold in any tax year for deaths up to April 2016 exceeds £250k, or £500k for deaths after April 2016
- PRs must provide basic information, including information regarding their identity and that of the deceased.

Back to contents>

Fundraising Regulator issues new rulebook for private site fundraising

The Fundraising Regulator has issued a new rulebook for private site fundraising as part of wider changes introduced to standards for face-to-face fundraisers.

The rulebook follows a review of the standards for face-to-face fundraising carried out by the Regulator in collaboration with the Institute for Fundraising. The review found that whilst the rulebook covers fundraising in high streets, there is a need for a rulebook that covers privately owned sites, such as shopping centres and supermarkets.

The rulebook focuses on site specific standards which will apply to fundraisers working in local areas. This includes:

- avoiding behaviours that could cause members of the public to become startled or anxious or bring the charity represented into disrepute and
- being clearly identifiable as a fundraiser by wearing an identification badge and, where appropriate, charity branded clothing.

The existing rulebook for street and door-to-door fundraisers has also been updated to strengthen the links between the rulebook and the Code of Fundraising Practice. The revised versions distinguish between the Fundraising Regulator's public-facing role and the operational compliance role carried out by the Institute of Fundraising with its members, clarifying that the Fundraising Regulator will deal with public concerns through its standard complaints procedure.

A copy of the new guidelines are available to view here.

Back to contents>

Case reports

Ann Legg and another v Aaron Burton and others[6]

The High Court has held that mutual wills can be upheld on the basis of evidence of an express agreement between the testators of their intention to create mutual wills.

Background

The claimants were the daughters of the testatrix, Mrs Clark. The defendants were the two grandsons of the testatrix and one of the grandsons' partners.

On 25 July 2000, the testatrix and her husband, Mr Clark, each made an identical will giving the property of the testator to the surviving spouse absolutely and to the claimants in equal shares if the spouse did not survive the maker.

At the time of execution of the wills, the testators expressly agreed that each will would mirror the other and that the wills could not be revoked. The solicitor informed the testators that everything was "set in stone" and that, although the law could not stop someone from changing their will in the future, the testators had made an express promise to each other and had to trust that they would both honour this promise.

The first claimant was present when the wills were signed, the second claimant arrived shortly afterwards. The first claimant raised concerns that the express agreement was not reflected in writing in the wills. The testators assured the claimants that the promise they had made to each other would be honoured and the wills would not be changed should one of them die.

Mr Clark died unexpectedly in 2001. In the years following Mr Clark's death, the testatrix made 13 subsequent wills due in part to a shift in relations with her daughters. At one point, in 2004, when informed by the testatrix that she was thinking of changing her will, the second claimant reminded the testatrix that she had made an irrevocable will. The testatrix told the second claimant she would not change her will. In actual fact, her will had already been changed and the testatrix then had the will changed back.

Mrs Clark died in 2016, having made a later will in 2014. The share of the estate to be received by the claimants was different to that specified in the original will and there were additional beneficiaries. The claimants asked the Court to find that the original will was a mutual will and therefore could not be revoked. As such, the will of 2000 should replace the 2014 will and the claimants should be entitled to the testatrix's entire estate absolutely in equal shares.

Held

The Court held that there was clear evidence that the wills made in 2000 were subject to an express agreement between the testators that the wills would be mutual.

The Court confirmed that mutual wills do not need to be proved on direct evidence of an agreement between the testators, but may be proved on extrinsic evidence alone. The claimants' evidence in this case was all indirect because they had been children at the time and could only testify to the intentions of the testators. However, the sequence of events and conversations had between the claimants and the testatrix made it clear that in 2000 there was an intention to create mutual wills.

6. [2017] EWHC 2088 (Ch).

The Court also considered the principles of constructive trusts produced by the doctrine of mutual wills. In the instant case, there was an intention that the wills would be irrevocable and there was no specific clause that a trust was needed to implement the intention. The estate was the subject matter, but this did not become a trust imposed on the death of the first to die unless that was agreed. The mutual will agreement left no uncertainty as to the subject matter of the trust. When Mr Clark died, the testatrix no longer retained the unilateral right to dispose of her assets.

The Court concluded that the express promise by Mr and Mrs Clark that the wills executed in 2000 were to be irrevocable, engaged the principle of mutual wills. Despite the testatrix's actions in acting inconsistently with the promise she made to Mr Clark, that did not prevent the Court finding that there was an express promise not to change the wills and Mr Clark relied on this promise.

Comment
This judgment provides an interesting consideration of the doctrine of mutual wills and the way in which they are formed. Ultimately, it is possible to determine that a will is mutual based on circumstantial evidence alone. The Court also confirmed that a mutual will can create a constructive trust.

A copy of the judgment is available to view here.

Back to contents>

JSC Mezhdunarodniy Promyshlenniy Bank & Anor v Pugachev & Ors[7]

The High Court held that a settlor of five discretionary trusts was the true owner of the trust assets.

Background
The case concerns five New Zealand trusts. The first defendant, Mr Sergei Pugachev, was a wealthy Russian businessman who was active in Russian politics and was elected as a Senator of the Russian Federation in 2001.

Following the financial crisis of 2008, between 2011 and 2013 Mr Pugachev purported to settle US$95 million worth of assets on five discretionary trusts. Mr Pugachev was named as a discretionary beneficiary, and had extensive powers as protector in each of the trust deeds. In 2015, the claimants obtained a judgment against Mr Pugachev and in 2016 they brought proceedings in the High Court to enforce the judgment against the assets in the trusts.

The claimants relied upon the following arguments in claiming to be able to enforce against the assets in the trusts:

- Mr Pugachev's position as settlor and discretionary beneficiary, together with his extensive powers as protector, meant that the true effect of the deeds of trust was to create bare trusts for Mr Pugachev (the illusory trust claim)
- the true intention was to create bare trusts for Mr Pugachev, therefore rendering the discretionary trusts shams (the sham claim), and
- the trusts should be set aside under section 423 of the Insolvency Act 1986 (transactions defrauding creditors) (the section 423 claim).

7. [2017] EWHC 2426 (Ch).

Held

The illusory trust' claim

The Court noted that Mr Pugachev's powers enabled him to remove trustees "with or without cause", and were purely personal powers in the sense that they could be exercised by him in his own interests and without regard to the interests of the other beneficiaries.

The Court concluded that the trusts did not divest Mr Pugachev of the beneficial interest he had in the assets transferred. In substance, the deeds allowed Mr Pugachev to retain his beneficial ownership of the assets.

The sham claim

The Court concluded that Mr Pugachev intended to retain ultimate control of the assets and he intended to use the trusts to hide his ownership of the assets. His method of exercising control was through his position as protector of the trusts.

The case on sham depended on whether the trustees and Mr Pugachev subjectively intended Mr Pugachev to have complete control and ownership of the trusts' assets. In the view of the Court, the trust deeds were a sham as Mr Pugachev intended to use them to create a false impression as to his true intentions and the trustees went along with that intention.

The section 423 claim

In view of its conclusions in relation to the illusory trust and sham claims, the Court concluded that if the trust deeds did operate to divest Mr Pugachev of his beneficial interest in the assets, then their purpose was to hide his control of the assets from his creditors and the trusts should be set aside under section 423 of the Insolvency Act 1986.

Comment

Each case must be determined on its own specific facts, but this decision will be welcomed by creditors seeking to argue that settlors of discretionary trusts are the true owners of the trust assets. In appropriate circumstances, the High Court will be prepared to find that a settlor of a discretionary trust has retained his beneficial in the assets which were purportedly settled on trust.

A copy of the judgment is available to view here.

Back to contents>

UBS AG London Branch v (1) Glas Trust Corp Ltd (2) Fairhold Securitisation Ltd[8]

In a dispute concerning a failed securitisation transaction, the High Court considered whether a note trustee was entitled to meet certain legal and financial expenses of the noteholders. The court decided that the note trustee could not pay the expenses without a review first taking place as to whether they properly fell within the trustee's expenses clause in the deeds governing the transaction. The Court commented on the appropriate approach to be taken in construing the relevant clause, and provided its preliminary view on the expenses.

Background

In a dispute concerning a securitisation transaction, the claimant bank sought declaratory relief against the first defendant note trustee and the second defendant issuer of the notes, in respect of whether the trustee could pay certain expenses.

8. [2017] EWHC 1788 (Comm).

The issuer had issued notes to various noteholders, which were sophisticated financial institutions. The issuer's obligations were backed by assets within a portfolio of sheltered housing. The cash flow generated by those assets was to be used to repay the issuer's debts to the noteholders and to the bank. The cash flow was not enough to support the issuer's liability. The noteholders formed a group (AHG) and directed the note trustee to meet certain legal and financial expenses of AHG (the AHG expenses).

The issue to be determined was whether the note trustee was entitled to make the payments. The claimant bank's case was that it could not. The dispute raised a point of construction of identical clauses in each of two deeds governing the securitisation transaction. The clauses were entitled "Remuneration and indemnification of the note trustee" and dealt with the obligation of the issuer to pay legal fees and other costs and expenses properly incurred by the note trustee in relation to the exercise of its powers and duties in relation to the transaction.

The claimant submitted that the AHG expenses were not expenses which could be incurred by the note trustee under the terms of the relevant clauses in the deeds. The note trustee disputed that argument, but conceded at the hearing that adoption of the expenses depended on a determination as to whether they properly fell within the provisions, whether the amounts were excessive, and whether payment was in conformity with its powers as set out in the transaction documents.

The Court said that the note trustee could not pay the AHG expenses at the current time. Given the note trustee's concession that adoption of the expenses depended on a review first taking place, the claimant had succeeded in making good its objections. The Court commented that the case had "morphed" into one in which the note trustee was effectively seeking the Court's directions as to whether the AHG expenses could properly be incurred. The evidence which would enable the Court to give such directions was not available to it.

The note trustee therefore changed its position during the course of the trial and said that it no longer maintained that it was entitled to incur and claim reimbursement of the AHG expenses without determining on a case-by-case basis whether such expenses properly fell within the relevant provisions of the transaction document.

Held

In relation to the construction of the trustee's expenses clauses, the Court said that such clauses were typically widely drafted and, in the context of a financial transaction, should be given a commercial and not artificially restricted meaning. That reflected the fact that the exercise of the trustee's powers might contain a substantial measure of judgement, might be controversial, and might have to be carried out speedily to enable resolution of the transaction. The Court observed that trustees should be confident that if they fulfilled their duties in a commercially reasonable manner, they would be entitled to indemnification.

With regard to the relevant expenses, the Court's preliminary views were:

- there were four categories of work identified by the note trustee in which its expenses had been properly incurred: (i) advising on the different possible ways in which the issuer security might be enforced; (ii) advising as to whether enforcement was appropriate; (iii) advising on the valuation of any assets subject to the issuer security; (iv) participating in negotiations with any interested commercial party in relation to items (i) to (iii)

- expenses incurred in relation to restructuring might be adopted, even though restructuring was not a note trustee's concern, but a matter between competing creditors
- the note trustee's proposed mechanism for identifying "properly incurred" expenses, which involved obtaining a letter from the relevant AHG adviser, describing the work in some detail and providing a breakdown, might be said to direct the responsibility towards the AHG advisers rather than the note trustee. The trustee accepted, however, that it had a duty to exercise independent discretion. The proposed mechanism might be the only realistic alternative to the note trustee incurring very considerable expense on analysis or advice, which might be duplicative and turn out not to be particularly controversial. It was reasonable to expect co-operation between the parties.

Comment

This case emphasises the importance for trustees ensuring that they follow the terms of the trust deed carefully and ensure that when incurring any expenses, they are incurred properly and in line with the transaction documentation. The case also highlights the importance of a trustees maintaining their independence and ensuring that they do not act blindly on another party's instructions.

A copy of the judgment is available to view here.

Back to contents>

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