The Common Law Trust as a Liable Party: The Panama Case[1]

Borja García Rato
Summons Lawyers

The economic development and evolution of globalization has brought with it the need to adopt legal-administrative measures from an intergovernmental level to prevent money laundering and the financing of terrorism. Regulators and legislators must pay special attention to those figures that allow acting on behalf of third parties without having the possibility to know who – whether a physical person or legal person – that is actually behind the legal business. The common law trust shares these characteristics and is a corporate vehicle specially monitored for having inherent money laundering risks. Roman law does not govern this legal figure, but there are similar instruments that must be considered as such and, in short, as liable parties to whom the money laundering regulations apply. It is important to highlight the case of Panama, a jurisdiction under the common law system where these instruments are frequently used to carry out not only local but also international transactions.

Keywords: money laundering, trust, liable party, beneficial owner

INTRODUCTION AND REGULATORY FRAMEWORK

The Royal Spanish Academy (RAE) defines the term "laundering" -among other meanings- as *"adjusting black money to tax legality"*. Probably the root of the "money laundering" is the figure of the well-known *gangster* Al Capone, a figure who devised to "invest" in the laundry business those substantial profits obtained illegally in the hidden business of the Prohibition at the beginning of the 20th Century.

This ingenious invention had a long history, since it was not until 1986 -many years later- that the United States issued the *Money Laundering Control Act* and considered such action as a separate criminal offense.

The fast development of markets, globalization, economic growth and its inherent risks produced the creation of various international bodies concerned with the proliferation of money-laundering structures and scenarios.

As a result of these needs, the Financial Action Task Force ("**FATF**") was established in 1989 as an intergovernmental body that determines international standards for Anti-Money Laundering and and counter terrorist financing ("**AML**" or "**PBCyFT by its Spanish acronym**").

Similarly, the Organization for Economic Cooperation and Development (**"OECD"**) has applied to become the international regulatory body in this area.

Both bodies issue guidelines and recommendations in the light of market developments and the dangers of money laundering for the jurisdictions in which they collaborate.

The legal basis of the international regulatory system can be found in the FATF recommendations of 1990; a guide that was shown as a first outline of what it was considered that countries should incorporate into their legal-administrative system.

The European Union (at the time, the European Community) echoed the warning of the FATF; and Spain, as a member bound to transpose the dictates of the Council of the European Communities, enacted Law 19/1993 dated December 28th on certain measures regarding Anti-money laundering.

This regulation was the first advance of the Spanish legislator in the field of AML, but its condition of *newcomer* did not include as liable parties the trust structures.

Considering the proliferation of these situations, the 2003 FATF recommendations found it necessary to include as regulated entities those persons who act on behalf of third parties, defining them as:

> *Trust and Company Service Providers refers to all persons or businesses (...) which as a business, provide any of the following services to third parties (...) acting as (or arranging for another person to act as) a trustee of an express trust.*

This recommendation is included in the latest publication of the FATF recommendations of 2012, which also insists on the need to apply due diligence measures to *" Trust and company service providers – when they prepare for or carry out transactions for a client concerning the following activities (...)".*

The European legislator accepted this need and included as liable parties *Trust or company service providers (TCSP)*; a specification that has been transposed into Spanish law through Law 10/2010 dated April 28th on the prevention of money laundering and the financing of terrorism ("**Law 10/2010**") which repeals the already outdated Law 19/1993.

Specifically, article 2.1.o of Law 10/2010 considers the following persons as liable parties:

> *o) Persons who, in accordance with the specific regulations applicable in each case, provide the following services on behalf of third parties setting up companies or other legal persons; acting as managers or non-board secretaries or external advisers of a company, member of an association or similar roles in relation to other legal persons or arranging for another person to perform such functions; providing a registered office or a commercial, postal, administrative or other related service address for a company, an association or any other legal person or arrangement acting as or arranging for another person to act as a trustee in a trust or similar legal arrangement; or acting as a shareholder on behalf of another person, except for companies which are listed on a regulated market in the European Union and which are bound by disclosure requirements consistent with European Union law or equivalent international standards ensuring adequate transparency of proprietary information, or arranging for another person to act as such.*

It should be noted that the transposition[2] of the Fourth European Union Directive on AML[3] modifies Article 2.1.o of Law 10/2010 by stating that the liable parties will be "*those who provide the (...) services* ***on behalf of third parties***", instead of "*to third parties*". In other words, a more obvious transcription is made regarding the application of this provision to persons not acting on their own behalf, but on behalf of third parties.

Through this legal precept, the Spanish legislator ensures the consideration of the common law trust structures or *Trusts* as Liable Parties.

In addition, the Executive Service of the Commission for Anti-Money Laundering and Monetary Offences ("**SEPBLAC**" by its Spanish acronym), as the Spanish regulatory body, is in charge of interpreting and adapting what is indicated by the legislator, among others, in the Compliance guide regarding due diligence obligations in relation to common law *trusts* and other similar legal instruments, published in March 2019.

THE COMMON LAW *TRUST*

Definition

According to the SEPBLAC[4] *"The common law trust (hereinafter trust) is a figure originating in English law under which a person (trustee) controls property or rights for a specified purpose or for the benefit of a third party."*

In addition, the FATF and the European Directive[5] define this figure as *Trust and Company Service Providers* (*"TCSP"*), with particular reference to vehicles created to act in the name and on behalf of third parties.

The FATF expressly states that a *trust*, confidence or *TCSP* "*(...) has the same meaning as used by the FATF* [in its recommendations when referring to TCSP who arrange transactions or perform transactions for a customer] *and thus includes those persons and entities that, on a professional basis, participate in the creation, administration and management of corporate vehicles.*"[6]

As indicated by the General Council of the Spanish Notaries,[7] businesses of a fiduciary nature are those in which the *dominus negotti* is not the grantor or executor of the action.

In short, Article 2.1.o of Law 10/2010 refers to the provision of services on behalf of third parties such as the exercise of *trustee functions in a trust or similar legal instrument.*

Main Characteristics and Inherent Risks

The concern of the different regulators and legislators is caused by the use of this legal instrument to carry out activities that pose a risk to AML. Specifically, the FATF[8] when analyzing the vulnerabilities that can be faced by the Trust or TCSP says:

> "*Several jurisdictions also identified a number of red-flag indicators where TCSPs may be utilised in money laundering schemes: The use of foreign private foundations that operate in jurisdictions with secrecy*".

Likewise, in the last FATF publication dated June 2019,[9] taking up the indications of the recommendations made by the same body in 2012 and adhering to what the FATF itself advanced in its guide on transparency and real ownership,[10] it is stressed that ***complex corporate structures in which figures such as trusts intervene may be a risk factor in matters of AML.***

The same FATF publication of June 2019 argues that one of the vulnerabilities of *trust* structures is "shell companies" and[11] "dormant companies."[12]

According to the FATF definitions, these companies are corporate vehicles with no real activity that are set up to conceal the business' economic reality and the real ownership of the ultimate beneficiary.

The ultimate protection sought by legal operators is to prevent one person - physical or legal - from being able to conceal him/herself and act through another in a market which, ultimately, may not correspond to a true economic reason or reality.

Returning to the historical allegation, it would be something like detecting and preventing the risk of using the laundry market to "invest" money from other legally questionable businesses.

COMPARATIVE FRAMEWORK

The Trust in Third Countries

As its name states, the common law *trust* is an unregulated figure of the *common law* in Roman based legal systems.

In order to create a comprehensive protective framework, regulators and legislators have made an interpretive effort to look for similarities between the *common law* and civil law systems, finding in continental foundations the greatest of appearances.

In this connection, the FATF[13] states that " *A foundation (based on the Roman law is the civil law equivalent to a common law trust in that it may be used for the similar purposes.*"

Similarly, the OECD states that a foundation is the civil instrument closest to the *common law trust*.[14] In other words, the civil law does not provide for the figure of the *Trust*, but in order to avoid fraudulent legal situations, other instruments have come to be considered as similar to these and on which protection and surveillance measures should also be applied.

The Trust in Spain

Derived from our Roman origins, the Spanish jurisdiction does not include the figure of the *trus*t as such and the only trust regulation is found in the Civil Code in relation to inheritance.[15]

This type of trust has little to do with *Trusts,* although it shares the basic concept of acting on behalf of others. Specifically, Article 774 of the Civil Code regarding the settlor states the following:

> *The testator may substitute one or more persons for the heir or heirs designated in the event that they die before him/her, or are unwilling or unable to accept the inheritance.*

In Spain, the settlor is the person appointed by the testator to administer the estate - on behalf of third parties - in certain situations. It seems that the only similarities of this figure with the *Trust* is the underlying theoretical concept but in no case could it be considered as an analogous instrument to the common law trust.

On the other hand, following the indications provided by the FATF in terms of appearances with the common law, *the Spanish Law on Foundations*[16] defines this legal instrument as "The organizations incorporated for non-profit purposes which, by the will of their creators, have a lasting effect on their estate for the achievement of general interest purposes."

Although it is true that Spanish civil law includes foundations in its legal system and that, on their *motus propio*, they are liable parties in the area of AML[17], the difference with other jurisdictions -and with the common law- is that their purpose is one of general rather than private interest. In Spain it is not possible to create foundations whose interest is private.

The Panama Case

Without intending to fall into arguments far removed from objective facts, the animosity of certain legal agents towards this Central American country and their behavior in matters of AML is well known.

And this focus became even more evident when, in 2016, the International Consortium of Investigative Journalists made public the database and the complete list of names of the so-called "Panama Papers"[18]

On its part, the European Union established a list in 2017 of non-cooperative jurisdictions in tax matters in which Panama was included from the beginning.

As a result of the *cooperation and transparency efforts* made by this country, on March 12, 2019 it ceased to be part of this neglected list and on January 24, 2018 it signed a Multilateral Agreement with the OECD[19] to implement fiscal measures in order to avoid the erosion of the tax base and the profit transfer (commonly referred to as BEPS).

However, it seems that Panama has not properly fulfilled its duties and at the beginning of 2020 the European Union has again included this territory in its *blacklist*[20] which is integrated by the following countries:

- American Samoa;
- Cayman Islands;
- Fiji;
- Guam;
- Oman;
- Palau;
- Panama;
- Samoa;
- Trinidad and Tobago;

- United States Virgin Islands;
- Vanuatu; and,
- Seychelles.

According to the Council of the European Union, the purpose of the list *is not to point out and highlight countries, but to encourage positive change through cooperation.*[21]

This is not intended to prejudge that any economic activity carried out in Panama is related to money laundering or financing of terrorism, but the regulators in general and the SEPBLAC in specific analyze with special attention those operations in which any Panamanian agents are involved.

Private Interest Foundations

One of the economic vehicles most often targeted by AML are private interest foundations operating in some common law jurisdictions.

The OECD, in the same aforementioned report[22], argues that other jurisdictions including Panama allow the establishment of foundations for private purposes and highlights the inherent danger of these instruments due to their potential lack of transparency.

The Panamanian private interest foundation is a corporate instrument with its own legal personality regulated under Panamanian law[23] and whose economic activity may include private purposes.

The "founder" provides the assets required for the foundation incorporation, can be an individual or a corporation and the Panamanian legislation does not establish the obligation to identify the real or ultimate owner of the foundation.

Regarding the commercial requirements for the granting of the foundation deed, it must be determined, among other aspects, "*the method in which the beneficiaries of the foundation must be designated*"[24], but it is not necessary to identify these ultimate beneficiaries.

In other words, the regulation itself does not provide for the identification of the persons who will be beneficiaries of the revenues obtained from the private purposes of the foundation.

In view of this situation, SEPBLAC considers the following[25]:

> *The trust is a highly developed legal instrument that plays an important role in international economic movements. However, its opacity makes it prone to abuse and use in money laundering schemes.*

In conclusion, international bodies and regulators have repeatedly shown the possible similarity of these foundations to *trusts* or trust figures, being therefore considered as Liable Parties under the administrative regulations concerning AML.

CONSIDERATION AND OBLIGATIONS AS A LIABLE PARTY

The fact that Article 2.1.o of Law 10/2010 has included in its scope of application the exercise of *trustee functions in a trust or similar legal instrument involves that this figure must comply* the obligations required by the applicable regulations and are subject to the established sanctioning regime.

In general and without affecting the fact that it is not the object of this Article, the liable parties must comply with (i) due diligence measures, (ii) information obligations and (iii) internal control measures.

In the event of potential non-compliance, the liable parties would face the penalties and offenses laid down in Articles 50 et seq. of Law 10/2010; emphasizing that these could apply not only to the liable party but *also to those who hold the same administrative or management position* if they are *attributable to their intentional or negligent conduct.*[26]

REAL OWNERSHIP OF TRUST STRUCTURES

When acting with third liable parties, the trust structures -and therefore, the Private Interest Foundations- must be prepared to identify the beneficial owner of the economic vehicle.

This means that not only must they comply with the requirements demanded for being liable parties, but they must also identify their beneficial owner for the obligations incumbent on the rest of the liable parties.

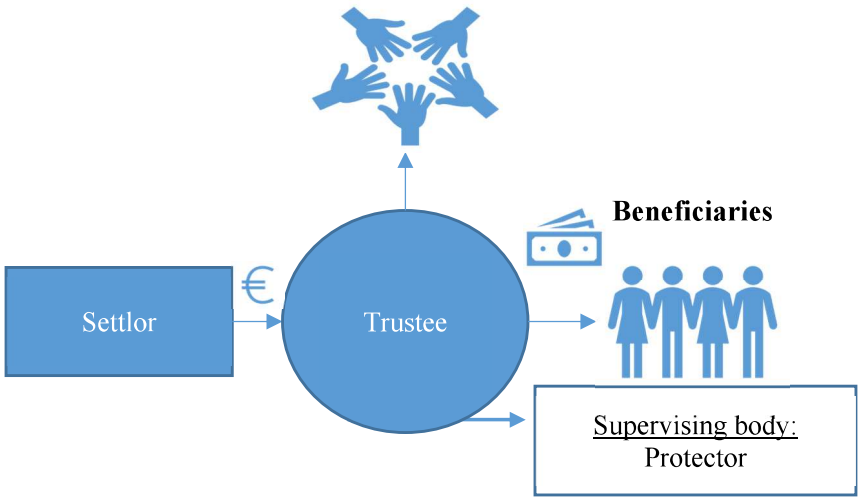
An example of this would be the deed of real ownership issued by a Notary when any operation requiring his/her authenticity is carried out. This record reveals the last person to exercise control over the signatory of the operation in question.

Article 4.1 of Law 10/2010 establishes that *the liable parties shall identify the beneficial owner and adopt adequate measures to verify its identity prior to the establishment of business relations or the execution of any operations.* The following persons are understood to be the beneficial owners:

a) Natural persons on whose behalf action is taken.
b) In the case of legal entities, these would be natural persons who ultimately own or control, directly or indirectly, more than 25 percent of the capital or voting rights, or who otherwise exercise direct or indirect control.
c) In the case of trusts, such as the common law trust, all of the following persons will be considered as beneficial owners:
    1. *The settlor;*
    2. *The trustee(s);*
    3. *The protector, if any;*
    4. *The beneficiaries, or where the individuals benefiting from the legal arrangement or entity have yet to be determined, the class of persons in whose main interest the legal arrangement or entity is set up or operates; and*
    5. *Any other natural person exercising ultimate control over the trust by means of direct or indirect ownership or by other means.*

Given the complexity of the trust structure and the lack of regulation at the national level, the legislator has considered it necessary to expressly indicate who the beneficial owners are.

FIGURE 1
NATURAL PERSONS EXERCISING CONTROL



Likewise, to enforce this obligation and not leave any body outside the scope of Law 10/2010, it is provided that *in the case of legal instruments analogous to the trust* (...) the identity *of persons occupying positions equivalent or similar to* the above shall be verified.[27]

For didactic purposes and in order to identify each of the related persons, a brief graphic description of the structure of a trust is provided:

Settlor

The settlor is the one who delivers the assets to the trustee and, in the framework of Panamanian Private Interest Foundations, is usually identified with the founder.

Sometimes this trust founder and creator reaches the point of ceding all his/her rights, interests and obligations to a third party that could be called the trustee founder.

This transfer of rights would be assimilated to what is known in Spanish law as a mandate contract[28]; the principal being the founder and the agent the person to whom the powers of representation are granted. By virtue of this mandate agreement, the trustee becomes a "voluntary representative" of the trust structure, empowering him/her to exercise all the rights and obligations of the trust.

In contrast to the condition of legal representative that arises from a legal situation imposed by the law, voluntary representation brings about an express and voluntary act - for the sake of redundancy - issued by a person or entity.

If this were the case, taking into account the legislator's position to extend the identification of all analogous figures to the settlor, the beneficial owners in this scenario would be the settlor him/herself, the founder and the founder-trustee to whom certain powers are delegated.

Trustee

The trustee is the person or entity that receives the settlor's assets for management and administration. In the framework of private interest foundations, if the settlor is the foundation's founder, the trustee would be the foundation itself, a commercial vehicle that receives the founder's assets for its management and administration.

Given the fact that the foundation is a legal entity, the natural persons who actually exercise control over it should be identified.

Only in the event that there were no individuals who controlled the foundation under the terms established by Article 4 of Law 10/2010 (i.e. holding of control), the members of the foundation's representative body would be its beneficial owners[29].

Protector

In certain jurisdictions - such as Panama - trusts are not subject to a supervisory regime by a regulatory body and the settlor may appoint, where appropriate, a protective body to control or supervise the economic vehicle's activities.

This supervisory agent is called a protector and is also considered to be the beneficial owner.

Beneficiaries

The beneficiaries or, where they have not yet been designated, the category of persons for whose benefit the legal structure has been created or operates, shall be the actual owners.

The beneficiary is the person or entity to whom the final enjoyment of the foundation's assets belongs. It should be noted that, as already indicated, the Panamanian regulations governing private interest foundations only require the determination of the means by which the beneficiaries of the foundation are to be designated, but not the specific identification of the beneficiaries. In any case, acting these legal instruments in Spain, they must identify these beneficiaries.

Person Exercising Effective Control

Finally, any individual who ultimately exercises control over the trust structure through direct or indirect ownership or other means will be considered the beneficial owner.

Note that the beneficial owners of the trust structure are all the persons identified here and cannot be limited to identifying only a portion of them.

REFERENCE DOCUMENTS AND WEBGRAPHY

- Notice 3/2010, of 6 July, from the Central Anti-Laundering Organization (OCP) of the General Council of Spanish Notaries.
- FATF publication dated October 13, 2006: *The Misuse of Corporate Vehicles, including Trust and Company Service Providers*.
- SEPBLAC publication March 2019: Compliance guide regarding due diligence obligations in relation to common law *trusts* and other similar legal instruments.
- FATF publication dated October 2014. *Transparency and Beneficial Ownership*.
- FATF publication dated June 2019. *Guidance for a Risk-Based Approach - Trust and Company Service Providers*
- FATF publication dated October 2010. *Money Laundering Using Trust and Company Service Providers.*
- OECD publication dated 2001. *Behind the Corporate Veil.*
- Council conclusions regarding the revised EU list of non-cooperative countries and territories for tax purposes 2020/C 64/03 ST/6129/2020/INIT.
- https://www.consilium.europa.eu/es/policies/eu-list-of-non-cooperative-jurisdictions.

ENDNOTES

1. This contribution is part of the R+D+i Research Project called " Investigation and evidence of money laundering. The 4th Directive" (Reference DER2016-80685-P) co-financed by MICINN/ERDF funds.
2. The European Union has issued 5 Directives on AML, the last one has yet to be transposed into Spanish law.
3. Directive (EU) 2015/849 of the European Parliament and of the Council dated May 20, 2015 concerning the prevention of the use of the financial system for the purpose of money laundering or financing of terrorism, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/7/EC.
4. See. Compliance guide regarding due diligence obligations in relation to common law trusts and other similar legal instruments, published by SEPBLAC March 2019.
5. Directive 2005/60/EC of the European Parliament and of the Council dated October 26, 2005 on the prevention of the use of the financial system for the purpose of money laundering and financing of terrorism; repealed by Directive (EU) 2015/849 of the European Parliament and of the Council dated May 20, 2015 but which has served as the basis for the transposition of Law 10/2010.
6. FATF publication dated October 13, 2006: *The Misuse of Corporate Vehicles, including Trust and Company Service Providers*.
7. Notice 3/2010, of 6 July, from the Central Anti-Laundering Organization (OCP) of the General Council of Spanish Notaries.
8. FATF Publication October 2010 *Money Laundering Using Trust and Company Service Providers*.
9. FATF publication dated June 2019. *Guidance for a Risk-Based Approach - Trust and Company Service Providers*.
10. FATF publication dated October 2019 - *Transparency and Beneficial Ownership*.
11. *Shell company*, defined as: A shell company is an incorporated company with no independent operations, significant assets, ongoing business activities, or employees.
12. Shelf company, defined as: *A shelf company is an incorporated company with inactive shareholders, directors, and secretary, which has been left dormant for a longer period even if a customer relationship has already been established*.
13. FATF publication dated October 13, 2006: *The Misuse of Corporate Vehicles, including Trust and Company Service Providers*.
14. OECD Publication 2001, *Behind the Corporate Veil*.
15. See. Articles 774 et seq. of the Civil Code.
16. Law 50/2002, dated December 26, on Foundations.
17. Article 2.1.x) of Law 10/2010.
18. *Offshore leaks database* as it is known.
19. Definition *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS.*

20. See. Council conclusions regarding the revised EU list of non-cooperative countries and territories for tax purposes 2020/C 64/03 ST/6129/2020/INIT.
21. Press release published at https://www.consilium.europa.eu/es/policies/eu-list-of-non-cooperative-jurisdictions.
22. OECD Publication 2001, *Behind the Corporate Veil*.
23. Law No. 25 dated June 12, 1995 of Panama "By which the Private Foundations are regulated."
24. Article 5.7 of Law No.25 dated June 12, 1995 of Panama "By which Private Foundations are regulated".
25. Compliance guide regarding due diligence obligations in relation to *trusts* and similar legal instruments. Published by SEPBLAC in March 2019.
26. Article 54 of Law 10/2010.
27. Article 4.2.d) of Law 10/2010.
28. See articles 1709 et seq. of the Civil Code.
29. Article 8.c) of Royal Decree 304/2014 of May 5th, approving the Regulation of Law 10/2010 of April 28th on AML.