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The FAFT, trusts and transparency in South Africa

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Over the past 10 years, there has been large-scale domestic and international financial fraud in South Africa. Sometimes, trusts and foundations are involved, including both South African and foreign trusts, as well as charitable trusts. This increase in cross-border fraud was highlighted during the Zondo Commission of Inquiry into State Capture, as well as in various reported cases being prosecuted by the National Prosecuting Authority ("**NPA**").

In 2022, the Financial Action Task Force ("**FATF**") identified key deficiencies in South Africa in relation to South Africa's prevention of money-laundering and terrorism financing. The FATF is an intergovernmental policymaking body sponsored by the G20, and more specifically the Group of 7 Nations ("**G7**") that oversees global efforts to combat money laundering and the financing of terrorism. The FATF does not impose sanctions, but other countries (or bodies and organisations like the European Union ("**EU**")) may impose economic sanctions on a particular country in response to an unfavourable FATF review report. For example, the EU could "Blacklist" a company on the FATF "Greylist" (see below). The FATF sponsored a Mutual Evaluation of South Africa, and issued a Report, which is discussed in this article.

Independently, but linked to the FATF Review, in 2021, the Financial Intelligence Centre ("**FIC**") conducted a money-laundering review and assessment of trust service provider sector, and issued a Report. Other Anti-Money Laundering ("**AML**") risk assessments were undertaken in 2022 by several other South African security and finance agencies. The FATF Mutual Evaluation Report, and the FIC Report, created the necessary momentum for the Cabinet to approve a National Strategy on AML, which was announced on 1 December 2022.

In response, National Treasury issued their Media Statement of 6 January 2023 on the proposed legislative response to all these assessments and reports in a clear attempt to prevent South Africa from being "Greylisted". Further legislative announcements are contained in the National Budget Speech of the Minister of Finance and in the 2023 Budget Review document.

This article sets out a summary of the new AML and Transparency Legislation, including those provisions directly or indirectly applicable to Trusts, and further including new regulations to the Trust Property Control Act, and other legislative developments.

FATF Key Deficiencies Noted

The Key Deficiencies which the FATF identified in relation to South Africa were contained in the 2022 FATF Mutual Evaluation Report on South Africa, which was issued on 1 October 2022. Over 100 deficiencies within 40 Categories were identified, and they were classified as partially-compliant (**PC**), low compliant (**LC**), or non-compliant (**NC**); Out of the 40 Categories reviewed, only 3 were found to be compliant; and 14 Categories were PC, 17 Categories were LC, and 5 Categories were NC.

The 5 NC Categories related to *inter alia* the following: first, South Africa had no targeted financial sanctions ("**TFS**") related to terrorism and terrorism financing ("**TF**"), and there had been delays in implementing United Nations Security Council Resolutions ("**UNSCR**") 1267, 1989 and 1998.

Secondly, South Africa had no specific AML rules for Non-Profit Organisations ("**NPO**") as well as no capacity to monitor NPOs at risk of TF abuse.

Thirdly, problems were identified in relation to Politically Exposed Persons ("**PEP**") and their family members, including problems with the definitions which are time-limited. Fourthly, South Africa had no special controls over new technologies (e.g. crypto) and other Virtual Asset Service Providers ("**VASP**") (known as Crypto Asset Service Providers ("**CASP**") in South Africa), which were not required to take AML/CFT measures. Lastly, too much reliance was placed on third parties for Customer Due Diligence ("**CDD**"), and there was no determination about in which countries third parties can be based.

The FATF Recommendations for South Africa

After their review, the FATF made 38 recommendations. Almost all of them impact directly or indirectly on trusts. Certain recommendations directly impacted on trusts, like preventing abuse regarding trusts which are NPOs, increased transparency regarding settlors, trustees, beneficiaries and protectors of trusts, and increased transparency regarding the beneficial owners of trusts; and obligations for providers of services to trusts.

Direct Results of FAFT Greylisting

When the FATF conducts a Mutual Evaluation which results in an unfavourable report, the reviewed country is given a time window to improve its AML and anti-FF legislation and enforcement mechanisms. If insufficient action is taken, the country is formally placed under increased FATF review, which is called "Greylisting". FATF Greylisting is therefore simply slang for a country being placed under increased and more formal monitoring by the FATF.

Greylisting leads to certain direct results, for example, not only is the relevant country placed under increased FATF scrutiny and review, but it must co-operate with the FATF; it must launch a time-based Action Plan which resolves the deficiencies; it must adhere to the Action Plan; and it must adopt a risk-based approach to continuous supervision.

Consequences of FATF Greylisting

Once Greylisted, the relevant country is regarded by other countries, and by global banks, as high-risk and therefore enhanced Client Due Diligence ("**CDD**") is required by banks, lawyers, accountants, trustees, etc in relation to their clients and customers. Further, citizens and residents generally have difficulty opening new foreign bank accounts *inter alia* due to the enhanced CDD; CDD must be done more frequently and may require due diligence reviews far down into supply chains; and bank account holders have difficulty in transferring funds into and out of the Greylisted country, and difficulty in transferring country-residents' funds into compliant countries including into the EU. Groups like the EU could place a Greylisted country onto their Blacklist for AML purposes.

Macro-Economic Consequences of Greylisting

Greylisting could lead to currency degradation, to inflation, and to trade deficits. Greylisting could also lead to difficulty in obtaining additional financing from global banks and bodies like the International Monetary Fund ("**IMF**"), the World Bank and the European Bank for Construction and Development. It has historically lead substantial decline in capital inflows and in foreign direct investment, with subsequent stagnating economy and job losses. This will likely be the case in South Africa in an economy which is already stagnating, and where further job losses cannot be afforded.

FIC Assessment of the Trust Service Provider Sector

As stated above, linked to the FATF Review, the FIC conducted a survey of the trust service provider industry in South Africa and reviewed the relevant legislation. The scope of the survey covered anyone providing services to trusts relating to administration, advice, and acting as trustee (but only if for compensation). The roles of so-called family trustees were excluded from the review. The FIC expects trustees to be able to identify money laundering, terrorist financing, tax evasion, and fraudulent activities. The Trust Property Control Act requires all South African trusts to have a bank account, all trustees are expected to be qualified to adhere to AML legislation in operating such accounts.

The FIC is particularly concerned about cash held by the tax exempt status of trusts, cross-border transactions, lack of transactions being recorded by trustees, particularly in tax schemes and abuse of the tax exempt status of NPOs, especially in relation to cross-border transactions.

Types of tax arrangements likely to be of concern to the FIC include the move of a trust's place of effective management ("**POEM**") to other countries, including Namibia, and especially to tax havens. The FIC is also concerned about local to foreign trust distributions relating to emigrants; loop structures with tax benefits; and foreign trust appointments onto local trusts (due to capital gains tax ("**CGT**") base cost step-up, etc.).

The FIC Report was taken into account in the FATF Mutual Evaluation process.

South African National Treasury Media Statement

As stated above, the clear aim of the creation of the National Strategy on Anti-Money Laundering, Counter Financing of Terrorism and Counter Financing of Proliferation and the National Risk Assessment, and of the Media Statement of 6 January 2023 was to prevent FATF "Greylisting",

potentially arising from the above reviews. The implementation of the strategy attempts to strengthen South Africa's financial systems by reducing levels of finance-related crimes. The Media Statement contained an announcement that the President had signed two main laws: the General Laws (the Anti-money Laundering and Combating Terrorism Financing) Amendment Act No 22 of 2022; and the Protection of Constitutional Democracy Against Terrorism and Related Activities Amendment Act No 23 of 2022 (also known as **POCDATARA**). Final FATF recommendations for their meeting of 24 February 2023.

The Media Statements included an announcement of further legislation or legislative amendments to follow, including the amendment of Trust Property Control Act, 1988; the new Regulations to the Trust Property Control Act, 1988; the amendment of the Companies Act, 2008; the amendment of Non-Profit Organisations Act, 1997; and the amendment of the Financial Sector Regulation Act, 2017.

Summary of the new AML and Transparency Legislation directly applicable to Companies

New wide definition of "**beneficial owner**" in the Companies Act which refers to an individual who controls a company, which could include a trustee of a trust; Requirement to maintain a register of **beneficial interests** and/or **beneficial owner(s)** of a company (must be an individual – cannot be a trust); and Additional grounds for disqualification to be a director of a company (Money Laundering ("**ML**") or TF, and United Nations ("**UN**") Security Council Sanctions).

Summary of the new AML and Transparency Legislation directly applicable to Trusts

New definition of "**beneficial owner**" has been inserted into the Trust Property Control Act, 1998 ("**TPCA**"), in terms of which the Beneficial owner of a South African trust must be natural person. Beneficial owners include the ultimate "**owner**" or "**controller**" of trust property, the founder, the trustees and the named beneficiaries. New provisions have been legislated in terms of which trustees must keep adequate records, as well as a register of beneficial owners. Trustees must also lodge the beneficial owner register with the Master of the High Court, who must keep his own register electronically. New offences have been created for trustees, and circumstances for disqualification to be a trustee have been set out.

New Regulations applicable to Trusts

There is a request for a new public electronic register of disqualified trustees (with reasons for the disqualification). There is also a new requirement that trustees must record details of transactions with **accountable institutions**. The new beneficial ownership register to be kept by the trustees is not a public register. However, it must be lodged with Master of the High Court where it will be open for inspection as set out below. Trustees will have to retain certified copies of beneficial owner IDs.

The Master of the High Court must keep beneficial ownership register: this is not a public register. Instead, it will be open to specified regulatory authorities, for example: South African Revenue Service ("**SARS**"); the Financial Surveillance Department of South African Reserve Bank ("**FinSurv**"); FIC; NPA; Independent Police Investigative Directorate ("**IPID**"); and any Special Investigative Unit of the SARS ("**SIU**") of the South African Police Service ("**SAPS**").

New legislation announced in the 2023 National Budget

In addition to the above, the following specific legislative changes announced in Annexure C of the 2023 Budget Review Document issued by the National Treasury are a direct or indirect result of the FATF Mutual Evaluation Report:

- **Expanding the general disclosure provisions for section 18A approved organisations:** In terms of the Tax Administration Act (2011), SARS may disclose a list of public benefit organisations approved in terms of section 18A and 30 of the Income Tax Act. Section 18A provides a tax deduction for donors to appeal public benefit organisation. As a broader range of entities than public benefit organisations may be granted approval to issue receipts for tax-deductible donations in terms of section 18A, it is proposed that SARS be explicitly empowered to publicly disclose all entities which have section 18A approval status.
- **Taxation of non-resident beneficiaries of South African trusts:** The gradual relaxation of exchange control regulations has led to an increase in applications to SARS for confirmation of tax compliance status of a person for purposes of transferring funds offshore via authorised dealers. The flow through of amounts from South African tax resident trusts to non-resident beneficiaries makes it difficult for SARS to collect income tax from those non-resident beneficiaries as it is more complicated to enforce recovery against non-residents. To address this, it is proposed that changes be made to section 25B of the Income Tax Act to align it with the capital gains tax provisions of paragraph 80 of the Eighth Schedule to the Income Tax Act.

- **Clarifying the meaning of "person" in the provisions dealing with public benefit organisations, recreational clubs and associations:** The Income Tax Act contains special tax dispensation for public benefit organisations, recreational clubs, and associations due to their non-profit status. Because these entities enjoy a special tax dispensation, various rules exist that limit the manner in which these entities operate or require greater accountability and stricter governance. These include requirements that the entity must have three unconnected persons who accept fiduciary responsibility and that no single person may directly or indirectly control the decision-making powers of the entity. Government has proposed amending the legislation to clarify that "person" in this context refers to a natural person, and not to a juristic person.

The Role of Lawyers

When a country is Greylisted, foreign and local law firms are required to conduct enhanced CDD and AML checks when taking on new clients, and even when providing new advice to existing clients. Lawyers would also start receiving increasing requests from clients, banks, trustees and other advisors for compliance reviews and confirmation letters, for example source of funds/wealth confirmations, tax compliance confirmations, exchange control compliance confirmations, and opinions on the compliance of tax structuring. South African lawyers should not issue such confirmation letters without first conducting detailed due diligence reviews of their client's affairs. Law firms will also be required to more closely monitor their client trust accounts.

What is the likelihood of South Africa being Greylisted?

By far the most serious and dramatic announcement made by the Minister of Finance in the 2023 National Budget Speech today, is that South Africans should be prepared for the possibility of FATF Greylisting later this week. According to the Minister, Mr Enoch Godongwana "*The FATF Plenary will make its decision later this week on whether or not to put South Africa under increased monitoring, otherwise known as the grey listing. We should be prepared for that possibility*".

Budget Speech 2023/2024: Tax Overview

This warning from the Minister comes despite the announcement today in Annexure C of the 2023 Budget Review document issued by his department, that various further legislative amendments are proposed to align with South Africa's National Strategy on Anti-Money Laundering, Counter Financing of Terrorism and Counter Financing of Proliferation, in order to achieve consistency with the new General Laws (Anti-Money Laundering and Combating Terrorism Financing) Amendment Act (2022) and also to take account of other developments in response to the findings of the FATF Mutual Evaluation Report of the FATF. In my opinion, FATF Greylisting in our case means that South Africa will automatically be placed on the EU AML Blacklist. This will have severely negative implications on our economy.



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