This white paper reflects my personal opinion.
It is written for the purpose of the ACAMS AML Advanced Audit training only.
The content is not in any way related to the (official) opinion of my employer.

In this white paper, I discuss the planned introduction of a mandatory compliance audit that Dutch trust offices have to perform. I will outline the background of the trust sector in the Netherlands and the applicable legislation, explain the expected new legislation, as well as discuss the challenges and opportunities this may bring to the Dutch trust sector.
1. Introduction

a. Summary

Trust offices in the Netherlands are companies that offer corporate services to their clients. Those services include, among others, being a manager of a legal entity and making an address available to a legal entity combined with an advisory role (e.g., on tax issues). Mainly international companies use these corporate services for tax-driven reasons. Currently those reasons are more and more criticized by the public.

Trust offices in the Netherlands need a license of the Central Bank of the Netherlands. There are currently 292 trust offices that actually hold such a license. They service between 16,000-17,000 clients altogether, who hold about 20,000 legal entities in the Netherlands. Those legal entities are mainly holding companies specifically established for tax purposes only. The real activities (e.g., production) are being carried out elsewhere by subsidiaries. With the establishment of such a legal entity and by using the services of a trust office, the client aims to create substance in the Netherlands. This substance is needed to actually benefit from certain Dutch tax advantages.

Dutch trust offices are supervised by the Central Bank. The applicable legislation and supervision is focused on anti-money laundering (AML). Currently, there is no legal obligation for trust offices to perform an audit on the compliance with the applicable legislation. The introduction of a mandatory audit, expected January 2015, will change that.

I expect the introduction of the mandatory audit to bring challenges to the Dutch trust sector. Those challenges lie in the establishment, the independency and the quality of the audit function, the focus and timeframe of the audit and the follow-up that needs to be given to the findings. However, I expect there to be opportunities for trust offices as well: by a faster discovering and tackling of potential compliance deficiencies, by taking compliance to the next level and, for third parties, by offering audit services to trust offices.

b. Structure

This white paper discusses the introduction of the compliance audit in trust offices in the Netherlands. It is written for the purpose of the Advanced AML Audit Training organized by ACAMS in Q1/Q2 2014.

I will first outline the background of the activities of trust offices in the Netherlands. Next, I will elaborate on the current legal framework along with an emphasis on the introduction of the mandatory audit. In conclusion, I will discuss the challenges and opportunities this audit may bring to the trust offices and trust sector in the Netherlands.
2. Trust Offices in the Netherlands

a. International Context
On May 4, 2009, U.S. President Barack Obama gave a speech in the White House on the topic of International Tax Policy Reform. During his speech, he showed a picture of an office building located in the Cayman Islands. This not so impressive building apparently houses multiple different businesses:

I used to talk about the outrage of a building in the Cayman Islands that had over 12,000 business -- businesses claim this building as their headquarters. And I've said before, either this is the largest building in the world or the largest tax scam in the world.¹

Although President Obama focused in his speech on this specific building, the issue raised goes far beyond the example in the Cayman Islands. The quote above forms part of an ongoing international debate about the social (un)acceptance of companies and wealthy individuals that look for the most efficient way to reduce or even eliminate taxes on their earnings or assets. In recent years, the discussion appears to be specifically focused on the so-called ‘tax planning’ by large international enterprises:

Companies have long had complicated tax structures, but a recent spate of stories has highlighted a number of tax-avoiding firms that are not seen to be playing their part. Starbucks, for example, had sales of £400m in the UK last year, but paid no corporation tax. It transferred some money to a Dutch sister company in royalty payments, bought coffee beans from Switzerland and paid high interest rates to borrow from other parts of the business (...) Everything these companies are doing is legal. It is avoidance and not evasion. But the tide of public opinion is visibly turning. Even 10 years ago news of a company minimising its corporation tax would have been more likely to be inside the business pages than on the front page².

In some cases, there is a thin line between the (legal) avoidance of taxes and the (illegal) evasion of taxes. But even when we look only at the avoidance of taxes, the current public opinion seriously questions whether that is ethically the right or acceptable thing to do. Personally, I do not think there is a black and white answer.

On one hand, companies have to ensure that they make enough profit to guarantee continuity and satisfy their shareholders. Tax planning may be an important part of this aim. Ironically, by signing multiple tax treaties, countries themselves pave an essential part of the way for such international tax planning. This ‘pavement’ of treaties is frequently used by international (tax) consultancy firms to help companies and wealthy individuals find strategies to maximize profits through different jurisdictions.

On the other hand, one should consider that the original intent of those tax treaties was never to pave such roads. The main purpose of these treaties is to prevent a company being charged the same tax twice by two different countries. The purpose was obviously never to have companies build legal structures in which certain countries play an

important role for tax reasons only. The U.S. Public Interest Research Group Education Fund and Citizens for Tax Justice wrote in their report Offshore Shell Games 2014:

Only 55 Fortune 500 companies disclose what they would expect to pay in U.S. taxes if these profits were not officially booked offshore. All told, these 55 companies would collectively owe $147.5 billion in additional federal taxes. To put this enormous sum in context, it represents more than the entire state budgets of California, Virginia, and Indiana combined. Based on these 55 corporations’ public disclosures, the average tax rate that they have collectively paid to other countries on this income is just 6.7 percent, suggesting that a large portion of this offshore money is booked to tax havens.\(^3\)

And then there is the argument of a lack of integrity and the social acceptance, or lack thereof. Even though tax treaties may offer from a technical point of view, the legal possibility to build tax-efficient structures, the public opinion about such structures changed dramatically in recent years. Until recently, issues regarding tax avoidance may be found on the business pages of a newspaper, if at all. However, now it is front page news frequently, especially when well-known international companies are involved:

*The Australian Financial Review* says that Apple Sales International has reported more than $US100bn (A$112bn) of profits in the last five years. Its accounts show it has paid less than 50¢ in tax on every $1000 of income. Last May the US Senate’s Permanent Subcommittee on Investigations revealed how Apple was using Irish offshore companies that it considered as 'stateless' -- not obliged to report to any tax authority in the world -- to route much of its overseas income through tax-free. Ireland closed the 'stateless' loophole but it didn't impact the Irish companies in West Atlantic tax havens that are part of the 'Double Irish Dutch Sandwich' tax-dodging scheme.\(^4\)

And:

*Starbucks*’ coffee menu famously baffles some people. In Britain, it’s their accounts that are confusing. Starbucks has been telling investors the business was profitable, even as it consistently reported losses. This apparent contradiction arises from tax avoidance, and sheds light on perfectly legal tactics used by multinationals the world over. Starbucks stands out because it has told investors one thing and the taxman another.\(^5\)

---


b. The Role of Trust Offices in the Netherlands

Companies may use the services of corporate services providers (trust offices) to help them reduce their tax obligations. Trust offices are in many cases used to create physical presence (substance) of a company in a certain country.

In the Netherlands, the services offered by trust offices include the following:

- **Being a manager or partner of a legal entity or partnership;**
- **Making an address or correspondence address available to a legal entity or partnership, if at least one of the ancillary activities listed below is provided for the benefit of that legal entity or partnership or for the benefit of another legal entity, partnership or natural person belonging to the same group:**
  i) Providing advice or assistance in the area of private law;
  ii) Providing tax advice or preparing tax returns and related work;
  iii) Performing work in connection with preparing, reviewing or auditing financial statements or keeping accounting records;
  iv) Recruiting a manager for the legal entity or partnership.
- **Selling legal entities.**

Trust offices offer their services to so-called object companies (doelvennootschappen). Those object companies tend to be a besloten vennootschap or B.V., which is the equivalent of a Limited in the Netherlands. In many cases, such object companies act as a holding company within a bigger international structure. The actual business activities of the company (e.g., production) are normally carried out by subsidiaries of the holding, located outside of the Netherlands.

The figure below gives an example of such a structure:

![Diagram of a trust office structure]

Currently, there are 292 licensed trust offices in the Netherlands. They differ in size and focus. Large trust offices exist with hundreds of employees and international

---

6 The activities mentioned in this white paper are corporate services. The meaning of ‘trust’ in this context therefore differs substantially from the ‘trust’ that involves the administration of assets on behalf of a third party.

7 Section 1, d, Act on the Supervision of Trust Offices.
representation in multiple jurisdictions. Those companies in general aim their business on providing services to large international corporate clients. On the other end of the spectrum, we see single-person trust offices that rely on the corporate services they offer to a few specific clients. Sometimes they have a focus on clients coming from a specific country or region.

Altogether, the trust offices provide corporate services to approximately 16,400 international clients, who hold about 20,000 legal entities in the Netherlands.8

There are three main reasons viewed from a tax perspective for the fairly large trust sector in the Netherlands. In short, these three reasons are:

- The large number of tax treaties that the Dutch government has signed with other countries;9
- The participation exemption (deelnemingsvrijstelling). When this exemption applies, no Dutch income tax is due on qualifying income received from a participation;
- Advance tax ruling by the Dutch tax authorities. This ruling offers clarity in advance about the taxes that one has to pay in the Netherlands.

*Eighty of the world’s 100 biggest companies have set up Dutch operations for tax reasons. In particular, special holding and finance companies are a popular option (...) The rise in foreign companies setting up special vehicles in the Netherlands is due to a combination of generous tax breaks on participations and advance tax treaties.*10

Against this background, there is an ongoing debate in the Netherlands, politically and publicly, about the (un)desirability of the Dutch trust sector. It is a discussion that touches on topics as integrity, jobs and the international tax context. Literature and newspaper articles add to the flavor of the discussion, as indicated by the popularity of the blunt question: “Why do Dutch citizens have to pay taxes and international companies do not?”

---

9 http://www.rijksoverheid.nl/onderwerpen/belastingen-voor-ondernemers/documenten-en-publicaties/circulaires/2014/01/01/verdragenoverzicht-per-1-januari-2014.html (in Dutch); currently 90-100 treaties are signed.
3. Applicable Legislation and Supervision

a. Legislation on trust offices in the Netherlands

The regulation on trust offices in the Netherlands has been in place since January 1, 2004. Financial integrity was (and is) the reason for the establishment. Other aims that are sometimes found in financial legislation, like soundness or consumer protection, are not an intention.

*The aim of the bill is to promote the integrity of the financial system by regulating the trust industry. As a significant part of the existing code of conduct (including customer due diligence) will be put on a statutory basis and thus apply generally, the bill contributes to combating the laundering of the proceeds of criminal conduct (including corruption and tax fraud) through legal entities and partnerships established in the Netherlands. This is of great importance for the protection of the good reputation of the national financial sector.*

The applicable legislation in the Netherlands currently includes:

- The Act on the Supervision of Trust Offices (“Wtt”);
- The Regulation on sound operational management relating to the Act on the Supervision of Trust Offices (“Rib”)12. The “Rib” deals with the specific requirements;
- The Anti-Money Laundering Act (“Wwft”). In the “Wwft” the requirement is set, among others, that trust offices are required to file unusual transactions with the Financial Intelligence Unit in the Netherlands.

The main focus of the regulation lies fully on AML. Mitigating the risk of being abused for such purposes should therefore be a major issue for every trust office that operates in the Netherlands. The international context is to be found in the Financial Action Task Force (FATF) and the Organisation for Economic Co-operation and Development (OECD) reports13.

*Alongside the positive aspects of these activities for trust offices and other financial service providers, certain conduit structures also make the Netherlands vulnerable [...] In the main, these seem to be structures which terminate in a jurisdiction where information on the ultimate beneficial owner is completely unavailable or cannot be exchanged with foreign governments. The OECD also describes these risks in its report on the misuse of legal entities and puts forward proposals to limit them. The ministers of the OECD countries stated at their annual conference that this report will assist member states in their efforts against money laundering and corruption. The FATF emphasises the importance of financial service providers (trust and company service providers) who co-operate in setting up and maintaining such structures knowing the identity of the ultimate beneficial owner*.14

---

11 Act on The Supervision of Trust Offices, Explanatory Memorandum, December 2013.
14 Act on The Supervision of Trust Offices, Explanatory Memorandum, December 2013.
b. Legal Requirements for Trust Offices in the Netherlands
The main purpose of the Act on the Supervision of Trust Offices or “Wtt” was to establish the trust offices to become a gatekeeper. That means that trust offices are obliged to perform a thorough compliance check on potential clients, as well as carry out ongoing due diligence on existing clients. The specific requirements, in terms of what does a trust office minimally need to know about a client, are further explained in the “Rib.” In short, trust offices acting as a gatekeeper should at all times make sure that their services are only provided to those ultimate beneficial owners that do not use the structure and/or object company for money laundering purposes or any other criminal activity.

Under the abovementioned “Rib,” trust offices are required to:

- Identify the ultimate beneficial owner(s) and verify the identity;
- Determine the source of wealth of the ultimate beneficial owner(s);
- Determine the organizational structure;
- Understand the purpose of the structure (Why this structure? Why the Netherlands? Why this specific trust office?);
- Follow the flow of funds and understand the background of this flow (transaction monitoring).

A trust office has to perform a clear and robust risk assessment of the client, taking into consideration all the potential risk factors (e.g., specific client risk, country risk, business risk). With the risk assessment in hand, the trust office must determine how to mitigate those risks. The risk assessment should obviously be periodically updated.

The extent to which financial transactions have to be scrutinized depends on the overall risk of a client as well. As a bare minimum a trust office should compose a transaction profile of a client and have a transaction monitoring system in place that detects transactions that do not fit this profile and/or history and/or business activities of the client.

c. Supervision of Trust Offices in the Netherlands
The Central Bank of the Netherlands is one of the responsible authorities for AML/CFT supervision of financial institutions in the Netherlands. Among the institutions that are AML/CFT supervised by the Central Bank are banks, insurance companies, money remitters and money exchange houses. Against that background, it is inherently logical that the Minister of Finance designated the Central Bank in the “Wtt” as the AML/CFT supervisor for trust offices as well.

Trust offices have to apply for a license with the Central Bank. Obviously a license will only be granted if a trust office meets the set requirements. Among those requirements are:

- A fit and proper test of the policy makers (e.g., board members);
- A clear separation of duties between business and compliance;
- The production of an internal procedures manual.
Once a license is obtained, the trust office has the continuous obligation to notify the Central Bank of relevant changes (e.g., in the organizational structure, change of board members). When the Central Bank rejects these proposed changes and/or does not consider a new policy maker to be fit and proper, obviously these cannot take effect.

d. **Supervisory Powers of the Central Bank of the Netherlands**

As a supervisor, the Central Bank has the power to:

- Enter the premises of trust offices;
- Make inquiries;
- Obtain relevant documentation.

There is a legal obligation for trust offices to cooperate. Furthermore, the Dutch Administrative Act stipulates that the Central Bank has to carry out the supervisory duties in a proportionate and reasonable way.

Breaches of the applicable legislation may be dealt with by the Central Bank by taking formal measures. The ‘toolkit’ of formal measures consists of: impose a fine or incremental penalty, give binding instructions to the trust office, appoint a curator or ultimately revoke the license of the trust office. When a trust office is not cooperative with the supervisor, the Central Bank may impose an incremental penalty and/or fine as well.
4. New Legislation Ahead: The Compliance Audit

a. Background
As discussed in Section 3, the current applicable legislation on trust offices dates from 2004. Since then, multiple modifications have been made to the Act on the Supervision of Trust Offices (“Wtt”). All that time the Regulation on sound operational management relating to the Act on the Supervision of Trust Offices (“Rib”) stayed more or less unaltered. However, the Ministry of Finance in the Netherlands is currently composing new legislation that has to replace the prior “Rib.” The new “Rib” is foreseen to become effective in 2014, at a future date yet to be decided.

The new “Rib” will do the same as the old “Rib” did: elaborate on the specific requirements that trust offices have to meet. But, as far as I understand from the draft that was disclosed for consultation to the public, the new “Rib” will go into far more detail. Also, it will introduce certain new requirements. Apparently, the Minister of Finance has decided to use the new “Rib” to tighten the requirements and supervision on trust offices. That appears to be a strong business imperative given the background of concerns and ongoing debate referenced earlier.

b. The Compliance Audit
In the foreseen new “Rib,” one of the requirements that will be introduced is the mandatory audit on the compliance. The Minister of Finance will require trust offices to establish an audit function that audits the compliance activities and compliance function in an independent and effective way. According to the draft legislation, the audit has to focus on the applicable legislation and the internal procedure manual.

The draft legislation stipulates that trust offices have to guarantee the independency of the audit function and compliance function by establishing clear duties, responsibilities and competencies for both functions. Because of that, obviously a trust office has to ensure that the fulfilment of the audit function and compliance function are in no way combined.

The trust office also has to implement procedures regarding the reporting of the findings of the audit to the board of directors. And the audit reports need to be available to the Central Bank for a minimum of five years.

Trust offices will be allowed to outsource the audit function to a third party. In the explanatory notes with the new “Rib,” it is determined that if a trust office indeed decides to outsource the audit function, this may not be outsourced to a third party to whom the compliance function is also outsourced or has been outsourced. This does not only apply to this third party, but also to companies that form part of the same group as this third party (e.g., sister or mother company of the third party).

According to the new “Rib,” the Central Bank may set additional rules regarding the exercise of the audit function, including the effectiveness and independency. This power

---

16 http://www.internetconsultatie.nl/ribwtt.
may be used, for example, to determine how often an audit should be carried out or to set specific quality criteria the audit function has to meet.

5. Challenges and Opportunities Ahead

a. Current Situation
Few trust offices in the Netherlands currently have an audit function in place. Only some of the largest trust offices have either a national or international internal audit department that may be involved in AML/CFT audits as well. Although the lack of an audit function with most trust offices may be explicable because most are relatively small businesses, I have always found this a remarkable issue. Given the fact that the legislator explicitly appointed trust offices in 2004 as gatekeepers and therefore demands a very strong compliance function of them, it appears strange to me that a mandatory audit of the compliance activities and compliance function was not introduced straight from the start.

Because currently there is no obligation to establish an audit function and because most trust offices apparently did not feel the intrinsic need to establish one anyway, over the last ten years trust offices missed, in my opinion, many valuable possibilities and chances to detect and address certain deficiencies in the compliance within their own organization. Such a lack of internal ‘reflection’ goes beyond a missed opportunity. It also brings reputational and financial risks to the trust offices, which could have been prevented: because of findings of the supervisor, many trust offices were faced with serious measures. Those findings and measures may have been prevented if an efficient audit function would have been in place. Although an audit function will certainly not be a guarantee for an excellent compliance, it is definitely a valuable addition and an extra safeguard. In my opinion, one could say that an adequate and effective operating audit function and a serious follow up to the findings will definitely help mitigating the abovementioned risks trust offices are prone to. In that light and taking into consideration the ongoing debate about the (un)acceptance of tax avoidance, I think the timing of the introduction of the mandatory audit function is a rather good one, not in the least, for the trust sector itself.

The introduction of the audit function is likely to bring new challenges to the trust offices in the Netherlands. Challenges will differ relative to trust office size. In this paragraph, I will highlight the major challenges I expect that the trust sector may face. Although addressing those challenges will obviously involve effort and expense, I expect in return both separate trust offices and the trust sector as a whole, stand to gain. Therefore, I will discuss the potential opportunities as well.

b. Challenges

Establishment
How to establish the mandatory audit function will be the first challenge that the majority of the trust offices have to face. The upcoming legislation does not make any distinction between relatively small and large trust offices; they are all expected to establish an efficient and independent audit function.
For some of the larger trust offices, this will not be a major issue because they already have established an internal audit department. However, they do have to consider if the independency of the audit function is indeed guaranteed within their organization, especially between the compliance function and the audit function.

If an audit department yet needs to be established by a larger trust office, then the recruitment of qualified auditors (e.g., that have particular experience with auditing compliance and the necessary credentials) and guaranteeing the independency of the newborn audit function, are important issues to keep a close eye on.

For smaller trust offices, I expect the establishment of an internal audit function to be a bit more difficult. In most cases, those trust offices will not have an established audit department yet and therefore have to start from scratch. Obviously, for a smaller organization the establishment of an audit function may be very expensive and not so efficient. Also, it might be too difficult to guarantee the essential independency. Therefore, the decision those trust offices will have to make first is whether or not it is a sensible thing to build an internal audit function at all. If not, those trust offices will have to hire a third party instead that will operate as an external audit department.

**Independency**

Once the audit function is established, one can expect the supervisor to be continuously keen on whether or not the audit function is functioning fully independent indeed. Only then the audit function can be considered as a real ‘third line of defense.’ Rather than starting discussions about this with the supervisor, in my opinion trust offices could better take a pro-active approach to this issue and therefore evaluate the independency on a regular basis themselves.

**Quality**

An audit will only have additional value if the people that carry out the audit are well-trained and capable of doing the job. It appears to me a sensible thing to do for trust offices to keep a close eye on the quality of the audit as such. Does the audit meet our expectations? Is it performed in a thorough way and does it deal with the right topics? Are the findings and recommendations understandable and well-motivated? If not, obviously those shortcomings should be dealt with, for example by training, reviewing the focus and/or by the recruitment of new staff.

**Focus and Timeframe**

What will the audit function audit? How often will they do that? What adjustments do we have to make over the years regarding the focus of the audit? Those are all questions that need to be addressed by the trust office on a regular basis as well. At least one can expect a trust office to put the answers to such questions in an annual plan, approved by the board or audit committee.

**Follow-up**

Once the auditors present their findings, giving follow-up to those findings is arguably the most important next step forward. This demands a follow-up plan. Such a plan needs commitment of the Board and, at a minimum, should determine who is when and how and in what way going to take the necessary steps. Regular monitoring of the
implementation needs to be in place as well. Additionally, it seems a clever thing to me to make sure that all steps taken are properly documented: because of their own administrative organization and because trust offices can expect the supervisor at a certain point to ask for it.

c. Opportunities

Tackle Problems
Rather then being confronted with deficiencies by the supervisor, with the introduction of the audit function trust offices will have an additional opportunity to discover and tackle such shortcomings themselves internally. A well-functioning team of auditors, as a ‘third line of defense,’ should be capable of determining the shortcomings in the compliance function before the supervisor does. If the trust office then makes sure to give a solid and rapid follow-up on the findings, this will most likely prevent supervisory remarks and, in some cases, enforcement actions. Additionally, the supervisor may be happy to see that the trust office appears to be professional enough to detect deficiencies and acts instantly to address those deficiencies. Altogether this is not only desirable from a point of view of compliance, but also may ultimately save the trust office money and time.

Compliance to The Next Level
Especially in these days in which the business activities of trust offices are scrutinized by politicians and the public, it appears important to me that trust offices take compliance to the next level. And by that I mean show as a trust office and as a trust sector that you are on top of things and have an effective compliance function in place, that is capable indeed of building fences to prevent the office/the sector being abused for money laundering purposes. A solid audit function definitely will help to emphasize and substantiate that to the outside world. In the current business environment, I expect bona fide clients to be mainly interested in a trust office that can convince them of the fact that they take compliance seriously. A well-functioning audit department will definitely help to convince such a client; probably the last thing such a client would like to run into is compliance risks and reputational risks due to the fact that the trust office they use turns out to be insufficiently compliant.

And... Opportunities for Third Parties
Last but not least, I expect there definitely to be business opportunities for third-party companies offering external audit services to trust offices in the Netherlands. With the new legislation ahead there will most likely be an upcoming demand for specialized and experienced external audit teams. As far as I can see, there is still a lot of wasteland here, waited to be planted with new ‘audit crops.’