U.S.—CHINA PLANNING

Global planning for inbound wealth from China

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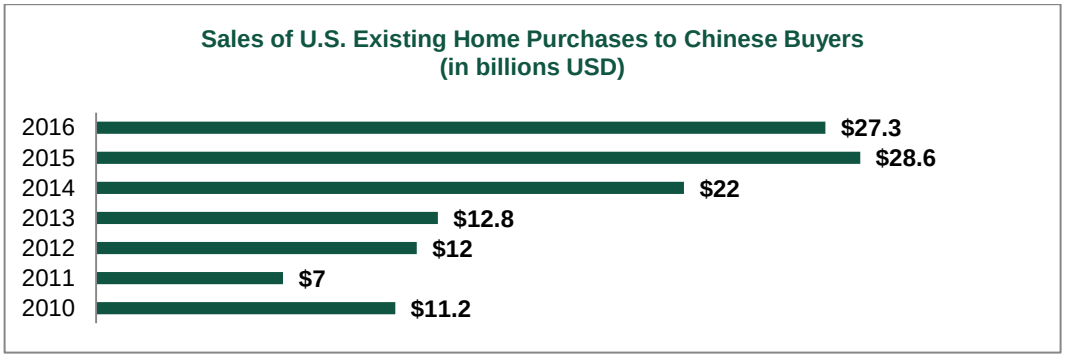
In today's global economy and mobile society, it is increasingly common for individuals to own assets internationally, for executives to have international assignments and for families to have members who live abroad or are citizens of various countries. From the U.S. perspective, the inbound migration of individuals and their wealth presents a number of planning opportunities and pitfalls for the uninitiated. In this *Insights on…Wealth Planning*, we provide an overview of the tax and wealth planning issues, considerations and implications applicable to U.S.-inbound Chinese individuals and their wealth from the U.S. planning perspective. Individual circumstances are unique and often complex. An individual's own attorney and tax advisors should be consulted regarding particular circumstances, both as to the U.S. and Chinese considerations.

U.S.-China cross-border activity is significant. Consider these trends:

- In the academic year ended May 2015, an estimated 304,040 Chinese students (31.2% of all international students) studied full-time at colleges and universities in the United States, up from 98,235 during the academic year ended 2009.[1]
- In Fiscal Year 2015, the U.S. issued 39,251 immigrant visas to individuals born in mainland China, with 77% being issued to individuals with family members having U.S. citizenship.[2]
- In Fiscal Year 2015, the U.S. issued 23,569 visas to Chinese immigrants under the EB-5 Immigrant Investor Program.[3] Under the EB-5 Immigrant Investor Program, foreign investors can obtain conditional visas that allow their families to live, work and attend school in the United States. To qualify, the individual must invest a minimum of $1 million in new or recently created businesses or $500,000 in businesses in rural or high-unemployment areas.
- China and the U.S. share one of the world's largest and most comprehensive trading relationships. China is currently the U.S.'s second-largest trading partner (after Canada) and its biggest source of imports. In 2015, China and the U.S. exchanged an estimated $659.4 billion of goods and services (up from $2 billion in 1979), with imports accounting for nearly $498 billion.[4]
- Chinese immigrants send substantial amounts of money, known as remittances, back to families in their countries of origin. In 2015, over $16 billion were remitted from the U.S. to China; between 2010 and 2015, over $85 billion were remitted from the U.S. to China.[5]
- Chinese investment in U.S. residential real estate represents significant market share, with Chinese buyers purchasing approximately $27 billion in residential real estate between April 2015 and March 2016, down from $28.6 billion during the previous 12-month period for the first time since 2011. California accounted for 32% of sales to Chinese buyers, followed by New York with 10% of total sales during the period. Approximately 40% of Chinese buyers purchased the property for use as a primary residence.[6]



PLANNING ISSUES TO CONSIDER

Regardless of why an individual may find herself in the U.S., there are U.S. tax and wealth planning issues for the Chinese individual and her U.S. advisors to consider. With the ever-evolving nature of international tax, foreign persons with activities in the U.S. and their U.S. advisors need to become aware of fundamental international tax principles. Failing to identify the critical differences between the U.S. taxation of U.S. persons and non-U.S. persons, and failing to plan accordingly, can lead to unanticipated and unnecessary application of U.S. tax and reporting requirements. The U.S. planning consequences are discussed in more detail below.

What is the individual's U.S. tax status?

One of the foremost considerations when dealing with a Chinese individual is her status from a U.S. tax perspective. Residence, domicile and citizenship each play a role in determining the proper application of the U.S. income tax and gift, estate and generation-skipping transfer taxes (collectively "transfer taxes"). The U.S. income and transfer tax regimes apply differently to foreign persons – non-U.S. resident non-U.S. citizens for U.S. income tax purposes (referred to as "NRAs") and non-U.S. citizens not domicile in the U.S. for transfer tax purposes (referred to as "NCNDs") – than they do to U.S. persons.

For U.S. income tax purposes, the Internal Revenue Code (the "Code") provides that a U.S. person means a citizen or resident of the U.S., a domestic corporation or partnership, and a U.S. trust or estate.[7] For U.S. transfer tax purposes, U.S. citizenship or domicile (not residence) is determinative.

Inadvertently triggering U.S. residence and domicile for a Chinese citizen can lead to:

- Liability for U.S. income tax on worldwide income (in conjunction with potential liability for Chinese income tax on worldwide income, but with certain income tax treaty relief).
- Liability for U.S. estate tax on worldwide assets.
- Mandatory U.S. foreign reporting requirements.
- Potential loss of Chinese citizenship.
- Potential loss of income tax treaty benefits.

The *United States – The People's Republic of China Income Tax Convention*, effective January 1, 1987 (the "U.S.-China Income Tax Treaty") provides relief in certain situations where the Code and the Individual Income Tax of the People's Republic of China conflict. There is no U.S.-China gift or estate tax treaty.

What U.S. income tax issues must be considered?

U.S. income tax is imposed on U.S. citizens and U.S. residents (collectively "U.S. persons") no matter where they live or move throughout the world. Additionally, a U.S. person's gross income – ordinary and capital gain – includes all income from whatever source derived. This jurisdictional reach will inevitably surprise the newly located U.S. resident who has substantial income from foreign sources, but who has immigrated or relocated to the U.S. without proper planning.

For U.S. income tax purposes, individuals who satisfy one of the tests for U.S. residence (described below) are, like U.S. citizens, U.S. persons subject to U.S. income taxation on their worldwide income. By contrast, NRAs are only subject to U.S. income tax on their U.S.-source income. An individual is considered a U.S. person for U.S. income tax purposes if she:

1. Is a lawful, permanent resident of the U.S. at any time during the year (a green card holder);
2. Meets the "substantial presence" test; or
3. Has elected to be taxed as a resident alien.[8]

An individual has a substantial presence in the U.S. if she is physically present in the U.S. for at least 183 days in the current year or if she has been present in the U.S. on at least 183 days during a three year period that includes the current year. The substantial presence test is satisfied if an individual is physically present for at least 31 days in the current year and the sum of the following equals or exceeds 183 days: (1) the number of days the individual was in the U.S. during the current year, (2) 1/3 of the number of days the individual was in the U.S. in the first preceding year, and (3) 1/6 of the number of days the individual was in the U.S. in the second preceding year.[9]

	Days in the U.S.	Applicable Factor	**Weighted Average**
Current Year	122	1	122
Last Year	122	1/3	40 2/3
Two Years Ago	122	1/6	20 1/3
Weighted Average			***183 days***

Although the substantial presence test is formula-based and seemingly straightforward, the integration of the China and U.S. income tax systems can create an outcome where an individual is considered to be a tax resident of each jurisdiction and therefore, subject to the income tax and tax filing requirements of each jurisdiction. However, even if an individual meets the substantial presence test, she may be able to claim a "closer connection" with another country.[10] In addition, there are exceptions to the substantial presence test that may allow certain individuals to avoid triggering U.S. person status for U.S. income tax purposes. For example, an individual holding a full-time student, teacher or trainee visa, or who is an employee of an international organization, will not satisfy the substantial presence test, regardless of the number of days spent in the United States.[11]

Example 1. Wei, a Chinese businessman, and his wife spend four months (*i.e.*, 120 days) per year, for three consecutive years, at their U.S. home in California to vacation with their daughter over her summer break from university and the remainder of the year in Beijing, China. Neither Wei nor his wife is a lawful, permanent resident of the U.S., nor have either elected to be taxed as a resident alien. Wei and his wife do not satisfy the U.S. substantial presence test and, therefore, will not be considered U.S. persons for U.S. income tax

purposes.

Example 2. The facts are the same as in the Example 1, except Wei and his wife extend their stay in the U.S. by four days in the current year in order to see their daughter graduate university. With this four day extension, they will satisfy the substantial presence test and trigger U.S. person status for U.S. income tax purposes for the current year.

The computations for analyzing these two scenarios are shown in the table below:

	Example 1 Days in the U.S.	Example 2 Days in the U.S.	Applicable Factor	**Example 1 Weighted Average**	**Example 2 Weighted Average**
Current Year	120	124	1	120	124
Last Year	120	120	1/3	40	40
Two Years Ago	120	120	1/6	20	20
Weighted Average				***180 days***	***184 days***

In order to resolve the dual residency issue and alleviate the potential for double taxation, the Chinese businessman and his wife might:

- Invoke the "closer connection exception" and claim a closer connection with China, if possible. This exception does not apply to individuals who are in the U.S. for 183 days or more in the current year (the year in which the exception is claimed).
- Claim exclusion under the U.S.-China income tax treaty, if possible.

Planning Tips:

- In order to avoid satisfying the substantial presence test, and thus obtaining U.S. person status for U.S. income tax purposes, individuals should limit physical presence in the U.S. to fewer than 122 days in any given year, unless an exception applies.
- It is important to maintain an accurate record of the number of days of presence.

NRAs are also subject to U.S. income taxation, but only to the extent that their income is deemed sourced to the United States. It is worth noting, however, that NRAs are treated in some respects more favorably under the Code for U.S. income tax purposes as they are subject to U.S. tax on fewer categories of U.S. income and U.S. assets than are U.S. persons. Accordingly, NRAs should carefully consider how they invest in U.S. markets. With proper planning, NRAs invested on a U.S. tax-efficient NRA investment platform can mitigate or eliminate U.S. income tax, as the case may be.

NRAs are subject to U.S. income tax on U.S. fixed, determinable and periodical ("FDAP") income, including interest, dividends, rent and royalties. Capital gain from dispositions of U.S. property, other than real property, is generally not subject to U.S. tax. The Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA") imposes a tax on the disposition of U.S. real property interests by foreign individuals and foreign corporations. Accordingly, it is important to discuss desired U.S. inbound investment activity with professional tax advisors beforehand to properly understand the U.S. income tax implications and which activities may be exempt from U.S. tax. (See the table below).

Type of U.S. Source Income	General U.S. Income Tax Treatment (subject to treaty modification)
Capital Gains (except U.S. real property gains)	Generally excluded from U.S. income tax. If the NRA was present in the U.S. for 183 days or more during the tax year, the net gain from sales or exchanges of capital assets are taxed at 30%. Capital gains are also subject to U.S. tax if they are effectively connected with a U.S. trade or business during the tax year ("ECI").
Capital Gains from the Sale of U.S. Real Property	Under FIRPTA, capital gains from the sale of U.S. real property are taxed on a net basis. However, 15% tax withholding is required based on gross sale price. Capital gain from the disposition of a residence for $1 million or less, withholding is required at a reduced rate of 10%. See IRS Forms 8288 and 8288-A.
Dividends	Dividends from U.S. corporations are generally included as U.S. source taxable income subject to 30% gross NRA tax withholding. A reduced treaty rate not to exceed 10% of the gross amount of the dividend may apply under the U.S.-China Income Tax Treaty.
Interest from Bank Accounts	Excluded from 30% gross NRA tax withholding unless ECI.
Interest from Bonds or Other Debt Obligations	Taxable and subject to 30% gross NRA tax withholding, unless the portfolio interest exception applies. A reduced treaty rate not to exceed 10% of the gross amount of interest may apply.
Portfolio Interest Exception	Excludes interest paid to NRAs on bonds and other debt obligations held for investment if: (i) The obligation is in registered form; (ii) the payee is a foreign individual or entity and is the beneficial owner of income; and (iii) the foreign individual or entity provides a Form W-8 to the payer. See IRS Forms W-8BEN, 1042 and 1042-S. Certain exceptions apply.
Rental Income	Rental income from the use of U.S. real estate is subject to 30% gross NRA tax withholding. However, a special election may be made to treat U.S. real property interests as ECI so tax may be paid on only the net income (income less deductions attributable to rental income). Timely U.S. tax returns must be filed to receive the benefit of this election.
Mutual Funds	Certain interest-related dividends and short-term capital gain dividends from U.S. issuers are excluded from U.S. income tax. Long-term capital gain distributions are excluded from U.S. tax. Note: the mutual fund will designate in writing which dividends are interest-related dividends and which are short-term capital gain dividends.

Will the U.S. transfer taxes apply?

Chinese individuals who own assets in the U.S. will undoubtedly question whether they are subject to the U.S. transfer taxes. U.S. citizens and U.S.-domiciliaries are subject to U.S. transfer taxes on their worldwide assets. On the other hand, NCNDs are subject to U.S. transfer taxes on only assets that have situs, or are situated (as defined), in the United States.

There are several important differences between the U.S. transfer taxation as applied to U.S. citizens and U.S. domiciled individuals and as applied to NCNDs. The table below highlights some of the key distinctions.

Differences in Application of U.S. Transfer Tax Rules

Category	Non-U.S. Citizen/Non-U.S. Domiciled	U.S. Citizen or U.S. Domiciliary
U.S. Estate Tax	Taxed on U.S. situs assets (real, tangible, intangible)	Taxed on worldwide assets
Applicable Exclusion Amount	$60,000, only available for estate tax purposes and not for lifetime gifts	$5,490,000 in 2017, available for gift, estate and generation-skipping transfer tax purposes
U.S. Gift Tax	Taxed on gratuitous transfers of U.S. situs tangible assets (real and personal)	Taxed on all gratuitous transfers
Annual Gift Tax Exclusion	▪ $14,000 in 2017 ▪ Gift splitting with spouse not allowed	▪ $14,000 in 2017 ▪ Gift splitting with U.S. citizen/domiciliary spouse allowed
Transfers to a Non-U.S. Citizen Spouse	▪ No unlimited marital deduction for transfers to non-U.S. citizen spouse ▪ Lifetime gift to non-U.S. citizen spouse, annual exclusion $149,000 in 2017	

The determination of whether an individual is a U.S. person is different for income tax purposes than it is for transfer tax purposes. Although residency is the determinative factor for income tax purposes, domicile is the determinative factor for transfer tax purposes.[12] Domicile is determined by the individual's personal facts and circumstances, including physical presence in a particular country and the intent to remain in that country indefinitely. Relevant factors include length of U.S. residence, green card status, location of business interests and employment, location of real and personal property, place of voting and social memberships and location of family members. Individuals may have more than one residence, but never more than one domicile.

The U.S. gift and estate taxes do not apply consistently to U.S.-situated assets owned by NCNDs. For estate tax purposes, U.S.-situs tangible and intangible assets are included, while for gift tax purposes, only U.S. tangible assets are subject to U.S. gift tax upon transfer; U.S. intangible assets, such as stocks, bonds and mutual funds, are excluded. See the table below.

From the U.S. Perspective: General Treatment of Select Assets of NCNDs for U.S. Transfer Tax Purposes

Asset Class	Considered U.S. Situs For Estate Tax Purposes	Considered U.S. Situs for Gift Tax Purposes
Foreign Situs Assets		
U.S. Real Property	X	X
Foreign Real Property		
U.S. Real Property Held by Foreign Corporation		
U.S. Bank Deposits (checking, savings, CD)		X
U.S. Brokerage Deposits	X	
U.S. Mutual Funds	X	
Tangible Personal Property Located in U.S.	X	X
Currency/Cash Located in the U.S.	X	X
Stock U.S. Corporation	X	

Example 3. Wei has a net worth of $10 million, which includes a $1.5 million home in the U.S. that he uses when travelling for business, a $1 million U.S. stock portfolio and a $500,000 U.S. bank account. Wei is domiciled in China and is a NCND for U.S. estate tax purposes. On Wei's death, his U.S. home and stock portfolio will be includible in Wei's gross estate and subject to U.S. estate tax because they are considered to have U.S.-situs. Wei's bank account will not be included in his gross estate because U.S. bank deposits do not have U.S.-situs. Thus, the $2.5 million of U.S.-situs assets will be subject to U.S. estate tax. Although Wei's estate may utilize the $60,000 applicable exclusion to lessen the tax blow, there is no U.S.-China estate tax treaty to provide any additional relief.

Example 4. The facts are the same as in Example 3 except that Wei's U.S. home is actually owned by Wei Inc., a Chinese corporation. On Wei's death, his U.S. home is no longer includible in his U.S. estate because, as shown in the table above, U.S. real property held by a foreign corporation is not considered to have U.S.-situs for estate tax purposes.

OVERVIEW OF THE CHINESE CONSIDERATIONS

China is one of the world's oldest civilizations, but it is only recently that China's wealth owners have started desiring and implementing modern inheritance and wealth transfer plans. One explanation for their increased interest is that the children – many now in their 60s – of the modern first generation Chinese wealth owners have frequently found themselves in court fighting over their parents' estates as a result of little to no pre-planning. Indeed, there is a Chinese saying, "Parents in heaven, children in court," which the second generation may be now trying to avoid.

A second explanation for the increased interest is that wealthy Chinese and their children are now often living abroad in countries that, unlike China, impose an estate or inheritance tax, such as the United States, prompting the need to plan for passing on their wealth to their children in a tax-efficient manner. As China's private wealth owners continue to rapidly multiply – from 124,000 individuals with a net worth of USD $1 million or more in 2001 to over 1.2 million individuals in 2015[13] – interest in sophisticated wealth transfer planning solutions continues to develop.

Planning Tips:

- There is no U.S.-China estate tax treaty and the income tax treaty does not provide any relief from the U.S. transfer tax system as it applies to NCNDs. Therefore, individuals may be subject to the full extent of federal estate taxes and state estate and inheritance taxes, as the case may be, without relief.
- With the enactment of its trust law in 2001, the use of private trusts is still in its infancy in China, especially as there remains substantial uncertainty in the law and lack of formal regulation regarding their use for private wealth planning purposes.

Does the Chinese individual need a U.S.-based wealth transfer plan?

Although a Chinese NCND may wish to have a U.S. power of attorney to deal with U.S. assets, or a U.S. health care directive to conform to the laws of the state in which the individual may spend time (and to ensure ease of use and acceptance), caution must be exercised when considering drafting multiple or replacement documents, particularly when it comes to U.S. wills and trusts. From a drafting perspective, absent prior planning, the execution of a U.S. will may invalidate any prior (and often essential) Chinese will, and the U.S. will may become subject to interpretation by a foreign jurisdiction.

For estates or property that will be governed by Chinese law, the importance of working with Chinese legal and tax advisors and ensuring the validity of a Chinese or foreign will cannot be emphasized more. Trusts have been recognized in China since 2001, and although

China's Trust Law specifically provides for the creation of a testamentary trust, there are no provisions for the use of inter vivos trusts or entities or regarding the use of foreign trusts for wealth transfer planning. Indeed, common U.S. trust planning strategies may be of little use to Chinese citizens, but in all cases interested individuals should discuss their particular planning situation with trusted tax and legal counsel.

PRE-IMMIGRATION PLANNING

If a Chinese NRA makes the U.S. her permanent home, there are numerous factors to be considered from the U.S. tax and wealth transfer planning perspective. Key considerations include U.S. residence status, U.S. income and transfer taxes, U.S. reporting and compliance requirements, and China's currency controls. As the saying goes, "think before you leap." In planning for immigration, NRA individuals are encouraged to consult competent legal and tax counsel who can assist them in understanding potential ramifications, making informed decisions and pre-planning based on their individual circumstances before coming to the United States.

PLANNING CONSIDERATIONS

Once the decision to seek U.S. citizenship or permanent residence status is made, it is prudent to determine – sooner than later – whether any actions can be taken to minimize U.S. income and transfer taxation in the future. Given the worldwide reach of the U.S. income and transfer tax regimes applicable to U.S. residents and domiciliaries, respectively, the most effective tax planning can be achieved prior to immigration to the U.S. because at that stage the individual is neither subject to U.S. income tax nor U.S. transfer tax on non-U.S. situs assets (and, in certain cases, enjoy a preferred status vis-à-vis U.S. intangible assets for gift transfers). This section will present certain planning considerations that could potentially save the newly-relocated U.S. person from both U.S. income and transfer taxes. As a reminder, any U.S. tax planning should be coordinated with the individual's home country tax planning under the guidance of home country advisors so as not to cause unanticipated or unintended consequences under the laws of the home country.

Income tax planning considerations

Pre-departure, pre-immigration income tax planning should always be considered before obtaining U.S. residence or citizenship. Consider accelerating income earned by the prospective U.S. taxpayer prior to becoming a resident. Possible income to accelerate includes compensation, pension plans, stock options, prepaid rents, royalties, dividends, interest, annuities and capital gains on appreciated assets.

Consider whether U.S.-source income that is considered FDAP income such as dividends, interest and rent, which is subject to 30% gross NRA withholding tax (or the reduced 10% treaty rate, if applicable), should be realized prior to attaining U.S. income tax residence. The possible advantage of accelerating the receipt of FDAP income is that U.S. tax residents are subject to U.S. income tax at higher graduated rates, especially when subject to a corresponding state income tax. Therefore, depending on the extent of the individual's income, it may be that 30% of gross proceeds, or the reduced treaty rate, would represent a tax savings as compared to much higher U.S. tax resident graduated rates, plus any applicable state income tax.

Consider accelerating gain in appreciated assets prior to becoming a U.S. tax resident. With the exception of U.S. real estate, NRAs are not subject to U.S. federal income tax on capital gains. It may be advisable, however, to defer recognizing deductible losses or paying deductible expenses until after immigration in order to utilize such amounts to offset U.S.

gains and other taxable income. Alternatively, the NRA individual may wish to elect U.S. person status early if she expects to recognize taxable losses in a prior year.

Prior to becoming a U.S. taxpayer, one should review current asset holdings – what type of assets are owned – and structures – how those assets are owned – as ownership structures that were tax efficient or otherwise useful before obtaining U.S. person status may no longer be advisable. U.S. persons who own controlled foreign corporation interests or passive foreign investment company interests may be subject to the harsh U.S. income anti-deferral tax regimes, which penalize accumulated income in foreign corporations or trusts. These anti-deferral rules prevent U.S. persons from avoiding U.S. income tax by conducting activities through foreign entities, which are not subject to income tax in the U.S. generally.[14] Importantly, a U.S. beneficiary of a foreign trust or estate that is a shareholder of a foreign corporation may be subject to these anti-deferral rules as well. As such, depending on the particular circumstances, it may be prudent to divest, gift or otherwise dispose of such interests. The NRA may avail herself of effective reorganization planning prior to immigrating as well.

Additionally, explore tax strategies that will step up the tax basis of assets to their fair market value so that only appreciation after becoming a U.S. tax resident will be subject to U.S. income tax. Unlike many jurisdictions, the United States does not allow an immigrating NRA to adjust the tax basis of her property to reflect its fair market value at the time the NRA becomes a U.S. tax resident. For example, a NRA could sell the appreciated asset, and then, to the extent desirable, reacquire the asset. The NRA must be mindful of any tax on the gain in her home country jurisdiction as it may have a higher tax rate. There are a number of strategies to consider in this regard and should be explored with tax counsel prior to immigrating.

Transfer tax planning

Pre-planning to avoid U.S. transfer taxes can be surprisingly straight forward, as NCNDs are subject to U.S. transfer taxes only on gratuitous transfers of property having U.S.-situs (as defined). Accordingly, up until an individual becomes a U.S. person for U.S. transfer tax purposes, she can gift unlimited amounts of non-U.S. situs assets (including U.S. intangible assets) without any U.S. tax implications. However, once one obtains U.S. citizenship or U.S. domicile, gifts made of any property – no matter where located – become subject to the U.S. transfer taxes when the transfers are cumulatively in excess the applicable exclusion amount of $5.49 million (in 2017). As a result, the period between the decision to emigrate and the date of immigration is ideal for making significant gifts of non-U.S. situs property, including U.S. intangible property, with no U.S. federal gift tax consequences.

Consider transferring assets to an NCND spouse before establishing a U.S. domicile. Sometimes it is advisable for assets owned in the name of one immigrating NCND spouse to be transferred to either the other immigrating spouse or a non-immigrating spouse, as applicable. If both spouses are immigrating to the United States, after they establish their U.S. domicile, gifts to non-U.S. citizen spouses will be subject to U.S. gift tax, with the exception of the $149,000 in 2017, adjusted for inflation, annual exclusion amount relevant for transfers to non-U.S. citizen spouses. If a substantial amount of assets are to be transferred from one NCND spouse to another, these transfers should occur for U.S. gift tax purposes before the NCND spouses establish domicile in the United States.

Trust planning

Consider a trust for wealth planning prior to moving to the United States. There are trust strategies that will benefit the NCND for U.S. transfer tax purposes whether the NCND is immigrating to the United States, has children who are moving to the United States or simply

wants to have investments in the United States on a U.S. tax-efficient investment platform (that is, an investment platform subject to a preferential tax regime for NRAs).

For the NCND who is not immigrating, but who has immigrating children, foreign grantor dynasty trusts present an interesting planning strategy. Often, NCND parents wish to help support their children when the children move to the United States. Or, the NCND parents want to have a structure that allows for the tax-efficient succession of wealth to U.S.-based children. NCND parents commonly use a foreign grantor trust to accomplish these tax objectives. The foreign grantor trust structure provides U.S. income tax efficiency during the NCND parents' lifetimes and provides a shield from U.S. transfer tax after the parent-grantor's death. The use of a foreign grantor trust may have the following outcomes for U.S. income and estate taxes:

- *For U.S. income tax purposes*, the NCND parents remain the deemed owners of the underlying trust assets. Qualifying a trust with a foreign grantor as a grantor trust under the grantor trust rules are more limited than for a U.S. person.[15] However, if properly structured as a grantor trust with a foreign grantor, foreign-sourced income and gains are not subject to tax in the U.S., and any U.S. investments invested on a U.S. tax-efficient NRA investment platform should be U.S. tax efficient. While the NCND parents are alive, there is no U.S. income tax drag at the trust level.
- *For U.S. estate tax purposes*, when the NCND parent(s) passes away, simply stated, the trust assets remain available for the benefit of the U.S.-based children. Those assets in a now-irrevocable dynasty trust should forever escape the U.S. estate tax net. At this point further planning may be required for U.S. income tax purposes, unless the requisite planning is incorporated into the trust document.

For the immigrating NRA, trusts can be very useful, but also very complex as well. Determining whether a trust is a foreign trust or a domestic trust, or a grantor or non-grantor trust, is essential in pre-immigration tax and wealth planning.

- If using an existing foreign non-grantor trust for the benefit of the immigrating NRA, the immigrating person should consider accelerating current and accumulated income in the foreign trust before becoming a U.S. person. There are harsh anti-deferral U.S. income tax implications for a U.S. person receiving accumulated distributions from a foreign non-grantor trust.
- If an immigrating NRA establishes a foreign non-grantor trust solely for the benefit of non-U.S. beneficiaries and retains no powers that would cause the NRA to be considered the deemed owner of the assets, the trust will be a separate foreign taxpayer and no U.S. income tax will be due, except on U.S.-source income (as defined above). Additionally, the trust assets would not be includible in the immigrating person's U.S. taxable estate at death. If a beneficiary of the trust later becomes a U.S. person, however, further planning would be necessary to avoid adverse U.S. income tax implications.
- If an immigrating NRA desires to remove assets from her potential U.S. taxable estate prior to immigrating to the U.S., as well as to shield those assets from the U.S. estate tax net for future generations of beneficiaries, the NRA might consider gifting unlimited foreign and/or U.S. intangible assets to a trust for the benefit of her children who are already living in the United States. The U.S. income tax implications that arise from this scenario can be complex depending upon whether the trust is domestic or foreign and depending on the timing of the impending move to the U.S., but the immigrating NRA can achieve both U.S. income and transfer tax efficiency with proper pre-immigration planning.

For example, and as a word of caution, if using a foreign trust for pre-immigration planning, if a NRA becomes a U.S. person within five years of transferring property to a foreign trust, with such trust having a U.S. beneficiary, such trust will be treated as a grantor trust as to the original foreign grantor for U.S. income tax purposes.[16] The complex U.S. tax rules that apply to foreign trusts and foreign grantors are beyond the scope of this *Insights*.

Planning Tips:

- Consider accelerating income before immigrating to the U.S. in order to take advantage of any preferential tax treatments that will disappear after becoming a U.S. taxpayer.
- Consider exploring strategies that will step up the tax basis of assets to fair market value so that only appreciation after becoming a U.S. tax resident will be taxable in the United States.
- Consider transferring assets to a NCND spouse before establishing U.S. domicile and becoming subject to the U.S. gift tax. For 2017, a donor can transfer up to $149,000 to a non-U.S. citizen spouse without becoming subject to U.S. gift tax. This is an eligible annual exclusion gift amount, adjusted for inflation.
- The use of private trusts for family wealth planning purposes is relatively new and largely operates in a gray area of Chinese law. A number of legal and regulatory issues remain unresolved regarding trust registration and taxation issues. Be sure to consult competent legal and tax counsel for any home country planning considerations.

ARE THERE ANY FOREIGN REPORTING REQUIREMENTS?

U.S. taxpayers are subject to a number of reporting obligations in connection with their interests in non-U.S. assets. Special attention must be paid to the complex and often non-intuitive foreign reporting rules.

FinCEN 114, Report of Foreign Bank and Financial Accounts of U.S. Persons

If a U.S. person has a financial interest in, or signature authority over, a foreign financial account, the U.S. Bank Secrecy Act may require the reporting of such accounts annually. For purposes of the FinCEN 114, a U.S. person includes U.S. individuals, trusts, estates and entities, and a foreign financial account is a financial account located outside of the United States and includes, but is not limited to, a securities brokerage, savings, demand, checking, deposit, time deposit, commodity futures or options account, a life insurance policy or annuity with a cash value, and shares in a mutual fund or similar pooled fund. U.S. persons are required to file a FinCEN 114 FBAR by April 15 if:

- The U.S. person had a financial interest in, or signature authority over, at least one financial account located outside of the United States; and
- The aggregate value of all foreign financial accounts exceeded $10,000 at any time during the calendar year reported.

Immigrating individuals should determine whether reporting will be required with regard to any remaining financial accounts maintained in the home country. FinCEN 114 reporting obligations may arise under the following common scenarios:

- A U.S. person is required to file and report even if she is not identified as the legal accountholder by the financial institutions where the account is maintained. Additionally, a U.S. person is required to file a FBAR if the person is acting on behalf of another as agent, nominee, attorney or other representative capacity.
- In the case of a grantor trust, the U.S. grantor treated as the owner of the trust is also treated as having a financial interest in any foreign financial accounts owned or held by the trust.

- In the case of a non-grantor trust, a U.S. beneficiary is treated as having a financial interest in any foreign financial accounts owned or held by the trust if the U.S. beneficiary has a beneficial interest in more than 5% of the assets or income of the trust.

Form 8938, Statement of Specified Foreign Financial Assets

In addition, as mandated by the U.S. Foreign Account Tax Compliance Act ("FATCA"), all specified individuals, including U.S. persons and certain nonresident aliens, who have an interest in specified foreign financial assets, must file a Form 8938, if the individual's foreign financial assets are more than $50,000 on the last day of the tax year or more than $75,000 at any time during the year. These reporting thresholds are $100,000 and $150,000 respectively for married individuals filing jointly. If an individual resides outside of the U.S. and is considered to have a presence abroad, the reporting threshold is satisfied only if the total value of the individual's specified foreign financial assets is more than $200,000 on the last day of the tax year or more than $300,000 at any time during the year ($400,000 and $600,000 respectively for married taxpayers filing jointly). A more comprehensive discussion of FATCA is beyond the scope of this *Insights*.

In addition to the FinCEN 114 FBAR and Form 8938 reporting requirements, U.S. taxpayers are subject to a number of other reporting and disclosure obligations with respect to their international asset holdings and transactions with foreign trusts and other entities. Penalties for failure to comply can be significant. This brief overview is not meant to be comprehensive and readers are encouraged to consult with their tax and legal advisors with regard to their U.S. reporting requirements.

What if a Chinese green card holder relinquishes her U.S. permanent residence?

Green card holders who formally relinquish their U.S. permanent residence may be subject to the U.S. expatriation rules under Code § 877A if they were green card holders for at least 8 of the last 15 years. These are the same rules that apply to U.S. citizens who renounce their citizenship.[17] If applicable, the expatriate's worldwide property is deemed sold on the date of expatriation and an immediate exit tax is imposed on the resulting gain at the applicable capital gains rate. Like U.S. citizens, green card holders and long-term residents benefit from the $600,000 capital gains exclusion from the expatriation tax rules, adjusted annually for inflation ($693,000 in 2016). Green card holders may continue to be subject to U.S. tax and reporting requirements until they formally expatriate. In this regard, individuals must file both:

1. Form I-407 with the Department of Homeland Security confirming the cessation of status.
2. Form 8854 under Code § 877 to notify the Internal Revenue Service of the change in status.

CONCLUSION

The confluence of the global economy, international investment and personal mobility in the modern day has resulted in a dynamic tax and wealth planning landscape. Planning for individuals moving across national borders requires an increasing degree of awareness of the implications of cross-border family relationships, investments, trusts and entities.

FOR MORE INFORMATION

As a premier financial firm, Northern Trust specializes in Goals Driven Wealth Management backed by innovative technology and a strong fiduciary heritage. For more than 125 years we have remained true to the same key principles – service, expertise and integrity – that continue to guide us today. Our Wealth Planning Advisory Services team leverages our

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[1] Institute of International Education, *Open Doors Report on International Educational Exchange: International Student Enrollment Trends, 1948/49-2014/15* (2015).
[2] U.S. Dep't of State, Bureau of Consular Affairs, *Report of the Visa Office 2015: Table III* (2016).
[3] U.S. Dep't of State, Bureau of Consular Affairs, *Report of the Visa Office 2015: Table V* (2016). Individuals who immigrate to the U.S. on EB-5 visas are treated as green card holders for U.S. income tax purposes and are subject to U.S. income taxation on their worldwide income until formally relinquished.
[4] Wayne M. Morrison, CRS, *China-U.S. Trade Issues* (Dec. 15, 2015).
[5] Migration Policy Institute tabulation of data from the World Bank Prospects Group. Annual Remittance Data (April 2016), available at http://www.worldbank.org/en/topic/migrationremittancesdiasporaissues/brief/migration-remittances-data.
[6] National Association of Realtors, 2016 Profile of Home Buying Activity of International Clients (June 2016).
[7] Code § 7701(a)(30).
[8] Code § 7701(b).
[9] Code § 7701(b)(3).
[10] Code § 7701(b)(3)(B).
[11] Code § 7701(b)95)(A)-(B).
[12] Treas. Reg. § 20.0-1(b)-1.
[13] BAIN & CO., THE EVOLUTION OF CHINA'S PRIVATE WEALTH MARKET 2 (2015).
[14] *See* Code §§ 951 – 965 and the Treasury Regulations thereunder.
[15] *See* Code § 672(f).
[16] *See generally* Code § 679(a)(4).
[17] The U.S. exit tax rules apply if an individual (1) has had an average annual net income tax liability for the preceding five years of more than $161,000 in 2016, (2) has a net worth of more than $2 million as of the expatriation date, or (3) fails to certify the she has complied with all U.S. federal tax obligations for the five years preceding emigration.