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China announces landmark rules on offshore trusts

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On July 24, 2026, China's Ministry of Finance and State Taxation Administration issued landmark announcements that establish a comprehensive framework for imposing China's individual income tax at a 20% rate on residents of China who transfer or have transferred property to or who receive distributions from offshore trusts (the New Rules).

The issuance of the New Rules is the first time China has publicly taken the position that its residents are subject to IIT when they transfer appreciated assets to offshore trusts, when their offshore trusts realize income and when they receive distributions of income from offshore trusts funded by non-residents.

Under the New Rules, an "offshore trust" is any trust or trust-like arrangement that wasn't established under Chinese law. For example, a family trust established under Delaware law by an individual for the benefit of the individual's family and administered in Delaware is an offshore trust.

Under the New Rules, Chinese tax residents are now subject to IIT on:

- the built-in gains in all property they transfer to offshore trusts, as well as the built-in gains in trust property when the trusts end and when they cease to be Chinese tax residents.
- all income earned in the offshore trusts they fund.
- the unrealized appreciation in property transferred from the trusts they fund to other persons.
- the income distributions they receive from offshore trusts funded by non-residents, as well as the entire value of distributions made by the trusts when they terminate.

If a nonresident transfers property to an offshore trust that's controlled by a Chinese resident, the Chinese resident will be deemed to have made the transfer to the offshore trust and taxed accordingly.

The New Rules are effective retroactively. The relevant statute of limitations are generally applicable, however, and should protect taxpayers from the obligation to pay IIT on income arising in offshore trusts and from IIT triggered by the transfer of property to offshore trusts for all years prior to 2021. To avoid late-payment surcharges, Chinese tax residents should report and pay tax on previously unreported income by Oct. 22, 2026.

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Who's a Chinese tax resident under the new rules?

Generally, an individual is a resident of China for purposes of the IIT in a particular tax year if they're domiciled in China or present in China for 183 days or more in that year. For purposes of the New Rules, an individual can be domiciled in China if they're a citizen or long-term or permanent resident of another jurisdiction, but their "primary economic interests are derived from within China."

Accordingly, a US citizen or green card holder residing in the United States could be treated as a Chinese tax resident for purposes of the New Rules if their "primary economic interests are derived from within China," subject to the application of the China-US Income Tax Treaty tie-breaker rule and determination by the competent authorities of both countries.

Taxation of resident settlors during their lifetimes

Under the New Rules, a Chinese tax resident (a resident settlor) who funds an offshore trust directly or indirectly will be subject to IIT on the built-in gains of the transferred property, whether the trust is revocable or irrevocable.

During the resident settlor's lifetime, each year the resident settlor will be subject to IIT on all trust income earned in that year. Capital losses may not offset the trust's or the settlor's other income. The trust's capital losses may not be carried forward to future years and may not offset its current year interest or dividend income.

When the trust ends during the resident settlor's lifetime, or when the resident settlor relinquishes Chinese residency, the settlor will be subject to IIT on all built-in gains of the property then held in the trust. Property transferred to the trust by the resident settlor that's still held in the trust will receive a basis step-up to its fair market value.

Under the New Rules, income arising in "foreign entities" that are "held, controlled, or managed" by an offshore trust will also be taxed currently to the trust's resident settlor during their lifetime (or to the successor resident who's treated as "inheriting" the trust on the resident settlor's death).

The IIT imposed on funding an offshore trust can result in harsh outcomes for US citizens or green card holders. For example, suppose a US citizen who's also a Chinese tax resident transfers $15 million worth of assets with a zero basis to a Delaware trust. No US or New York gift or income tax would be imposed on the transfer. But they would be subject to a 20% IIT on the $15 million gain. When the asset is sold in a later year for $15 million, either the settlor or the trust will be subject to an additional US tax on the same $15 million gain. There's currently no mechanism for providing a credit against the US tax for the IIT already paid.

Taxation when a resident settlor dies

Under the New Rules, when a resident settlor dies, if their offshore trust is "inherited" by a nonresident, the built-in gains would be subject to a one-time IIT. If, however, the offshore trust is "inherited" by another Chinese resident, that other Chinese resident would step into the shoes of the deceased resident and would be subject to all rules applicable previously to the resident settlor during the resident settlor's life.

An individual is treated as "inheriting" an offshore trust if they "succeed to the deceased individual's rights and interests in the trust."

While the policy goals are clear, guidance is needed to understand how the New Rules will work. Trusts generally have more than one beneficiary. Those beneficiaries could include Chinese residents and non-Chinese residents. The distributions made to the beneficiaries are likely to be determined at the trustee's discretion. In practice, it may be impossible to identify the individuals who inherit the offshore trust on the resident settlor's death.

Taxation of nonresident settlors

An individual who's not a tax resident of China may be subject to IIT on built-in gains from property transferred into an offshore trust if the gains are sourced from within China. The New Rules don't provide special sourcing rules. A US citizen living in New York could trigger this Chinese tax by transferring their interests in a Delaware limited liability company into their revocable trust if a substantial portion of the LLC's assets consists of Chinese real estate.

Additional guidance from Chinese tax authorities is needed to clarify how this portion of the New Rules work.

Taxation of trust beneficiaries

A Chinese tax resident who receives distributions from an offshore trust funded by a nonresident will be subject to IIT to the extent that the distributions consist of trust income. The New Rules don't specifically define trust income for this purpose. A Chinese tax resident will be subject to IIT on the entire value of distributed property if the property is distributed at the trust's termination. Both China and the United States can tax the same item of income in various distribution scenarios when a mismatch in taxpayers or timing denies foreign tax credits in either country.

Key takeaways

The New Rules represent a significant step forward in China's efforts to strengthen the efficacy of its worldwide taxation regime. However, additional guidance will be needed on a range of questions to ensure the proper implementation of the New Rules and to prevent unintended consequences, particularly for US/Chinese families engaged in legitimate cross-border tax planning.

Key areas where guidance from Chinese tax authorities is most urgently needed include: (1) what constitutes "primary economic interests derive from within China" under the New Rules; (2) the definition of "income" for purposes of beneficiary distributions; (3) the identification of the individual(s) who "inherit" a trust that has a broad class of beneficiaries and a discretionary distribution standard; and (4) the identification of the Chinese residents, other than the trustees, who would be treated as having the type of control that would render them taxpayers for offshore trusts funded by nonresidents.

Better coordination between Chinese tax authorities and US tax authorities on certain key issues discussed above can help prevent or mitigate double taxation.

Practitioners and affected families should monitor future regulatory developments closely and consider seeking legal advice in light of the Oct. 22, 2026 reporting deadline. Until additional guidance becomes available, they should be mindful of how their trusts are structured and how trust distributions are handled to avoid double taxation while strictly complying with Chinese laws and US laws.

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