French offshore trust anti-tax avoidance system and its enlightenment to China

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Abstract. In China, where wealth is unevenly distributed, high net worth individuals transfer their assets to offshore trusts. It will lead to widening the social gap between the rich and the poor, destroy the normal tax order. At present, China's offshore trust tax system is incomplete, and the tax supervision measures are not perfect. This paper compares the anti-tax avoidance measures of offshore trusts in China and France through comparative analysis, and summarizes the shortcomings of anti-tax avoidance measures of offshore trusts in China. In addition, by referring to the tax practices of offshore trusts in France, this paper puts forward measures to improve the anti-tax avoidance of offshore trusts in China.

Keywords: Offshore trust; Anti-tax avoidance; High net worth group; Controlled foreign enterprise; Tax regulation

1 Introduction

The General Secretary clearly pointed out that the whole people should move toward the goal of common prosperity, increase the income of low-income groups, and strictly outlaw illegal income. In the current social income distribution gap is large, the country to promote common prosperity in the background, but a large number of high-net-worth people out of the consideration of tax avoidance in the offshore trust phenomenon. In 2018, 15 domestic companies listed in Hong Kong alone transferred assets of up to $28.5 billion into offshore trusts.[1] When the trust system was set up, it had the natural attribute of tax avoidance. Now trusts play a significant role in reducing income tax, capital gains tax and inheritance tax. The French offshore trust in the estate tax, gift tax, income tax and other taxes have a clear regulation. Offshore trusts are also strictly regulated in France, where the reporting obligations of trustees are clearly stipulated in the general tax law. At the same time, it also makes clear the registration of offshore trust. In the case that the registration and reporting system of offshore trust in China is not perfect, the relevant provisions of France can bring some reference to China.

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2 Tax avoidance behavior of offshore trusts by Chinese high net worth individuals

At present, high net worth people in China have transferred their property to offshore trusts for the sake of property protection and tax avoidance.

Ma has placed 64.4 percent of Alibaba, worth about $111.9 billion, in a trust in the British Virgin Islands. As a trustee, Jack Ma holds most of Alibaba's shares through two companies in the British Virgin Islands. [2] According to the Special Trust Law of the British Virgin Islands, Jack Ma can still manage his shares through the holding company after transferring his shares to the offshore trust.

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First, high net worth individuals can avoid taxes by planning the nationality of the beneficiaries. Mr. Lei, for example, placed his shares in Xiaomi in a trust benefiting his family. Any dividends on his previous holdings would have been taxed in China on their income. But now, when the other beneficiaries are not Chinese tax residents, and when the beneficiary's home country does not tax share dividends, the purpose of tax avoidance through offshore trusts is achieved.

Second, offshore trusts can defer taxes. Relevant provisions may be made in the offshore trust contract. The trustee can only transfer the property to the beneficiary if certain conditions are met. Large assets will be distributed in planned installments to defer taxes.

Finally, use tax incentives for tax breaks, such as a rich Chinese put their assets in foreign trust companies, foreign trustee used this money to invest in domestic enterprises, the investment income belongs to foreign investment, no agency places within the territory of China a non-resident enterprise income obtained in China, you can apply to the preferential rate of 10%.

3 French Offshore Trust anti-avoidance tax system

In order to regulate the tax avoidance of offshore trusts, France has established its own trust tax system. It systematically and comprehensively defines the content of trust in tax legislation. The French government argues that trusts can easily be used to avoid taxes. Therefore, out of the consideration of anti-tax avoidance, France has formulated relevant provisions to strengthen the supervision of trusts and enhance the transparency of trusts. On the one hand, France has a clear definition of offshore trust, including how it is levied in various taxes such as inheritance tax, gift tax and income tax. On the other hand, offshore trusts are tightly regulated in France. The fiduciary reporting obligation is clearly stipulated in the French general tax law, and the registration of offshore trust is also clearly explained. Under the circumstances that the registration and reporting system of offshore trust are not perfect, the relevant regulations of France can bring some lessons to our country.

3.1 French tax principles

Under the French legal system, trusts themselves do not exist as legal persons, but French case law recognize the validity of offshore trusts, provided that existing French law is respected. According to French tax law, when the principal or beneficiary of a trust is tax resident in France, or a property, right or asset of the trust is located in France, the trustee is obliged to report to the French Inland Revenue and shall submit the trust Declaration and annual report. Products transferred to beneficiaries through trusts should be subject to personal income tax as chattel income, with the taxpayer having the option of being taxed at a flat rate of 30 per cent or at five progressive rates.

France has a single territorial jurisdiction. Taxpayers with a tax residence in France are taxed on their worldwide income, while taxpayers with a tax residence in another country are taxed only on their income originating in France.

3.2 Estate tax/Gift tax

In France, gratuitous transfers through trusts are subject to inheritance/gift tax. In France, if the settlor is a French resident, when he transfers the trust assets abroad, he needs to pay tax on his global trust assets. When the overseas trustee distributes the assets in the offshore trust to the beneficiaries with French resident status, the donation tax will be levied on the beneficiaries. The rate of gift tax is determined by the kinship between the trustor and the beneficiary. It is not feasible to avoid inheritance tax through offshore trust.[4]

3.3 The income tax

In France, when the trustee distributes the property in the offshore trust to the beneficiary, the beneficiary is supposed to pay personal income tax on the property acquired in the offshore trust. If the income generated by assets should be taxed, the income generated by capital distribution is not included in the tax scope.

France regulates the use of foreign entities for profit hoarding and tax deferral by tax residents through a controlled foreign enterprise tax system, which applies to companies and trusts.

A controlled offshore trust shall be deemed to have distributed the profits hoarded in the trust to tax residents in France if: first, the principal assets in the offshore trust are financial assets; Second, the French tax resident holds at least one tenth of the assets or rights in the offshore trust, and if the resident places the assets or rights in the offshore trust in a non-cooperative country or region, this regulation is also met; Finally, the offshore trust uses tax advantages to avoid tax, and the actual tax burden of the offshore trust is less than 40% of the tax payable in France of the trust in the same situation.

3.4 Tax regulation measures

France has broken the secrecy of offshore trusts by strengthening the supervision of tax information of offshore trusts and establishing a complete information disclosure and reporting system.

French stipulated in the amendment to the finance act the trustee shall have the obligation to report of the offshore trust, the trustee's reporting obligations include two types: one is based on the report of events, the trustee should trust establishment, alteration, cancellation and report to tax authorities within the trust assets, reporting period for the change of a month; The other is the annual report, in which the trustee shall report to the tax authority on June 15 of each year the market value of the trust assets and rights held on January 1 of that year. The trustee has a reporting obligation if either the principal, the trustee or at least one of the beneficiaries of the offshore trust is a French tax resident, in which case the worldwide assets of the trust shall be reported; Second, if at least one property or right in the trust is located in France, the trustee shall report to the Trustee on the assets located in France.

In 2013, France established a public register of trusts, and detailed implementation rules were released in 2016. According to the trust public registration system, the contents of the trust registration shall include: the date of establishment and termination of the trust, the information of the trust, the identity information of the trustor, the trustee and the beneficiary, the date of establishment and termination of the trust, and the date and nature of the trust statement. The trust registration information should be kept properly. France stipulates that the French tax authority should keep the trust registration information for ten years from the date of the trust's termination.2. Deficiencies of China's offshore trust anti-tax avoidance system

4 Deficiencies of China's offshore trust anti-tax avoidance system

4.1 The tax system of offshore trusts is not perfect

There is no tax policy for offshore trusts in existing tax laws. Offshore trust has a strong tax avoidance function in inheritance tax, gift tax, income tax and other direct taxes. First of all, although China has not yet imposed estate tax, many experts propose to impose estate tax in the context of the large gap of social income distribution and China's commitment to achieve common prosperity. Estate tax, as a direct tax, can play a role in redistributing social resources, which is consistent with the current conditions of China. In the author's opinion, if inheritance tax is to be levied, clear provisions must be made on the tax policy of offshore trust. Otherwise, it will not only play a role in adjusting social income, but also cause high net worth people to turn to offshore trust for tax avoidance and asset transfer.[5]

China's income tax also does not make specific provisions on offshore trust, but follows the existing income tax law. If the beneficiary is an enterprise, its share of offshore trust income shall be incorporated into other operating income and paid corporate income tax. If the beneficiary is an individual, the corresponding income should also be subject to individual income tax. For the beneficiary to pay individual income tax, the applicable tax items still need to have specific legislation to make clear.

4.2 The scope of China's controlled foreign enterprise tax system is small

China introduced a controlled foreign enterprise tax system in 2018. The system stipulates that the tax authorities have the right to make special tax adjustments to Chinese resident enterprises that set up their enterprises at a tax burden significantly lower than that of the country or region for tax avoidance. China's current tax system for controlled foreign enterprises cannot effectively regulate offshore trust anti avoidance, and the scope of the tax system for controlled foreign enterprises needs to be improved. Generally speaking, the more complete the scope of the system, the more tax avoidance behaviors that can be regulated through the system. In addition to including enterprises in the scope of the tax system for controlled foreign enterprises, France also includes trusts. China only includes enterprises, which is not conducive to combating anti tax avoidance through offshore trust.

4.3 The tax supervision mechanism is not perfect

China passed the Trust Law in 2001. However, the existing Trust Law can only provide general reference value for trust registration, and does not provide specific implementation rules, so it cannot be applied to the rapidly developing offshore trusts. Deficiencies of China's Trust Law:

First of all, the registration effect of Trust Law is too strict. It stipulates that the trust property and rights should be registered. If the parties do not register, the registration will be invalid, which will increase the cost and reduce the transaction efficiency.

Secondly, the legal status of registration institutions is unclear. In 2006, China Banking Regulatory Commission set up the Shanghai Trust Registration Center in Shanghai, which is conducive to improving the liquidity of trusts. However, the legal effect of the Shanghai Trust Registration Center is limited, resulting in the invalidity of the information registered in the Shanghai Trust Registration Center. Therefore, tax authorities cannot obtain legally effective trust registration information.

Finally, the registration of offshore trusts is too small. The registration scope of offshore trust should be as wide as possible, and the trust with practical contact with China should be merged into it. However, the scope of trust registration is limited to capital trust at present. If the trustee cannot register for other forms of trust, then offshore trust cannot be set up.

5 China's tax policy suggestions on improving anti-tax avoidance of offshore trusts

5.1 Improve the anti-tax avoidance tax system of offshore trusts

In order to adjust the social gap between the rich and the poor by levying estate tax, the offshore trust tax policy should be clearly stipulated in the process of legislation. First, determine the scope of the estate tax. For tax residents of China, the estate tax should be levied on their worldwide estates (including assets placed in offshore trusts). For non-tax residents of China, estate tax is payable only on their trust assets located in China. Second, China could set up an intermediary. After the principal places the property in the offshore trust, the trustee shall report to the tax authorities in China and execute the withholding obligation, and then distribute the withheld estate to the beneficiaries.

5.2 Expand the scope of the tax regime for controlled foreign enterprises

China currently only includes companies under its controlled foreign company tax regime, not trusts. This is not conducive to China's controlled foreign company tax system to regulate high net worth individuals using offshore trusts for tax deferral. China could learn from France's tax system for controlled foreign enterprises and expand its scope. It can not only make China's controlled foreign enterprise tax system more perfect, but also crack down on tax deferral. The conflict between the tax agreement and the tax system of controlled foreign enterprises may hinder the process of perfecting the tax system of controlled foreign enterprises in China. China can learn from France. The operating profit clause of the tax treaty states that the profits of a company in a contracting State can only be taxed in that contracting State. The controlled foreign enterprise provision gives the resident state the right to pay taxes on enterprises that do little or no profit distribution in the contracting State. In response, France has set up a corresponding exemption clause, which allows companies in countries with which France has concluded tax treaties to avoid anti-avoidance investigations. The controlled foreign company tax regime also cannot be applied to profit hoarding that is not for tax-deferred purposes.[6]

5.3 Improve the tax regulation of offshore trusts

Although there is a domestic trust registration system in China, the scope of the system is not comprehensive and the registration institution is not clear. China does not have a system for registration of offshore trust information. This is not conducive to improving tax transparency and strengthening tax supervision. China should establish an offshore trust information registration system based on French trust registration legislation experience.

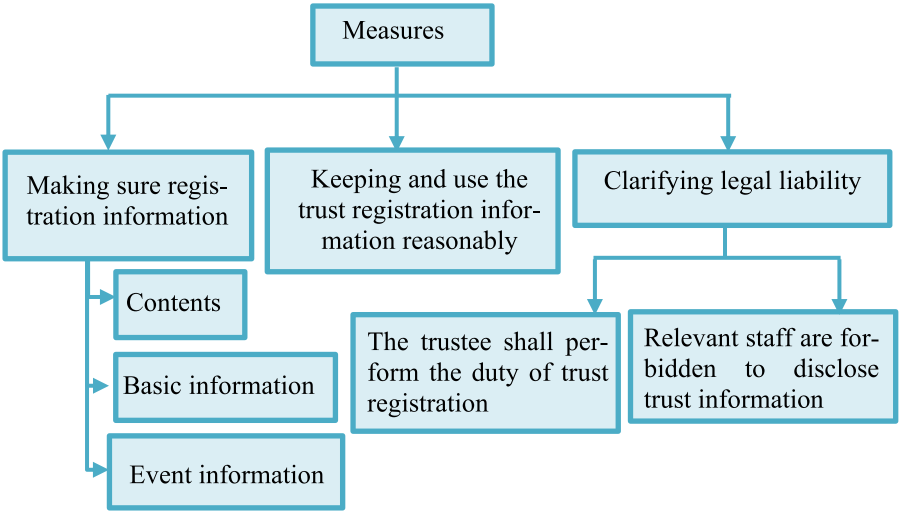

Fig. 1. The measures to improve China's tax collection and administration (Photo credit: Original)

6 Conclusions

Amid China's promotion of common prosperity, high net worth individuals are shifting their assets to offshore trusts to avoid taxes. At present, there are still some shortcomings in the regulation of offshore trust tax avoidance in China, including: the offshore trust tax system is not perfect, the scope of China's controlled foreign enterprise tax system is small, and the tax supervision mechanism is not perfect. The tax system of offshore trust in France is relatively perfect, and there are clear provisions on income tax and tax supervision measures in offshore trust. China can learn from the useful experience of France to improve the anti-tax avoidance tax system of offshore trusts and improve the tax supervision of offshore trusts.

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