Immigrants embrace the trust factor

In an increasingly mobile world, tens of thousands of Chinese nationals are migrating to the US each year. Navigating the tax issues that arise from moving assets across borders is challenging, but careful preparation – and using offshore trusts – can help.
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Four times a year the US Treasury Department publishes a list of individuals who have expatriated, either by renouncing citizenship or turning in their green cards. Between January and March 2012 – shortly before the cutoff date for submitting most income tax returns – 460 others expatriated. The following quarter, the total came to a more modest 189.

A large proportion of the names on these lists are of East Asian origin. This appears to tally with anecdotal evidence of Asians who once sought US citizenship now heading in the opposite direction, drawn by better job prospects arising from robust economic growth. But reports of the death of the American Dream – in Asian eyes, at least – are greatly exaggerated: The few hundred names seeking an exit are still far outnumbered by those on their way in.

Whether these immigrants are motivated by proximity to family members attending college in the US or a basic desire to sequester their assets and themselves in a more transparent and stable jurisdiction, wealth management issues shouldn’t be ignored. Much can be achieved through careful structuring before entering the US tax system; it is harder to act after the fact.

According to the US Department of Homeland Security, more than one million people obtained legal permanent resident status in 2011. Only two years in the last 10 has it fallen below this level. Of the one million, 87,000 were born in China, 69,000 in India, 57,000 in the Philippines, 34,000 in Vietnam and 22,800 in South Korea. The vast majority moved directly from their country of birth rather than through a third nation (and Hong Kong is categorised separately from China).

The growth in Chinese immigration to the US has been astounding – a product of the more mobile world and China's rising economic status within it. Between 1900 and 1989, just over 300,000 people giving their country of last residence as China obtained legal permanent resident status in America. In the subsequent 10-year period the total surpassed 340,000, rising to nearly 600,000 in the decade following that. The annual number has fluctuated since 2000, but there is a general upward trend.

It is worth noting that a recent survey by China Merchants Bank and Bain & Company found that 60% of Chinese worth $15 million or more have left the country or are planning to leave. Wealth protection is one of several motivating factors.

Once a US immigrant satisfies the substantial presence test – by residing in the country for either 183 days in any one year or at least 31 days in the current year and 183 equivalent days over a three-year period – or the green card test, he or she is immediately subject to US income tax. And once the immigrant is domiciled in the US, transfer taxes (gift tax, estate tax) come into effect.
Given the global reach of the US income tax system, it is difficult to address from an efficiency perspective. However, transfer tax exposure can be minimised through the use of a trust.

An international discretionary trust, or “drop off” trust, allows an individual to deposit assets held outside the US into an offshore structure prior to immigration. Legal ownership is transferred from settlor or grantor to the trustee and so the US revenue authorities are unable to claim gift tax or estate tax – a key consideration in terms of succession planning. In cases where the grantor is a non-US person, under US law, the trust must be established five years before the grantor immigrates to the US in order to qualify for non-grantor status.

Furthermore, if the trust has non-grantor status, the settlor isn’t taxed on income generated within the trust even after becoming a US resident.

An individual setting up a grantor trust retains certain rights and administrative powers and is therefore considered the owner of the assets for income tax purposes. With a non-grantor trust, control is completely relinquished and so the grantor is exempt from income and transfer taxes.

For individuals only planning to remain in the US for a set period of time, income tax liabilities can be reduced through a US tax qualified variable annuity program. Structured as a contract with an insurer, these investment products are tax-deferred, which means no payments are due until money is withdrawn.

The benefits of acquiring an annuity through an offshore trust are threefold: costs are lower and investment options wider than with onshore programs; if the trust is set up prior to immigration, the annuity isn’t liable for transfer taxes; and, if the individual leaves the US after a number of years, the annuity isn’t subject to any US tax whatsoever if surrendered after departure.

A trust can also accommodate a tax compliant universal life insurance policy for those who choose to remain in the US for the long term.

America has one of the most complex tax systems in the world and its worldwide reach presents a challenge – but prospective immigrants are advised to examine their wealth management strategies regardless of the destination. Trust-based solutions are ubiquitous. Canada, for example, taxes residents on worldwide income and capital gains, but allows immigrants to shelter assets in an offshore trust for the first 60 months of their residency.

The speed with which trusts have come to the fore in this context – several years ago most clients knew nothing of them – attests to the increasingly sophisticated approach now taken towards wealth and succession planning. OIL’s internal market research suggests this is just the beginning of the trend: over the next decade wealthy individuals and their families will take asset protection and wealth management more seriously – whether they stay in China or not.

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