Hong Kong Strategy

Key takeaways from expert call on new Offshore Trust Tax rules

Equity Strategy

Hong Kong

Angus Chan
Analyst
angus.chan@ubs.com
+852-2971 7530

Ryan Lau
Analyst
ryan-za.lau@ubs.com
+852-2971 7954

Mark Leung
Analyst
mark.leung@ubs.com
+852-2971 8636

James Wang
Strategist
james-zb.wang@ubs.com
+852-3712 2557

John Lam, CFA
Analyst
john-za.lam@ubs.com
+852-2971 6358

Tommy Tang, CFA
Strategist
tommy.tang@ubs.com
+852-2971 8357

Perry Yeung
Analyst
perry.yeung@ubs.com
+852-2971 6349

New tax rules provides greater clarity on offshore trust tax treatment

There's been increasing market concerns on the going tax clawback and its potential impact since the announcement of Article 21 by the mainland tax authorities governing offshore trusts. We hosted an expert call **(replay link)** to discuss the latest developments (simplified transcript on page 2). The expert noted that Article 21 provides greater clarity on the tax treatment of offshore trust structures by establishing a tax collection framework that applies across the entire trust lifecycle, including trust establishment, ongoing operation, and termination. The expert further highlighted the broad scope of the new rules, covering both Chinese and non-Chinese residents, as well as trust structures ranging from relatively modest arrangements to ultra-high-net-worth portfolios. The expert believes China is progressively moving toward a global taxation framework that is more closely aligned with those of advanced economies. With Hong Kong expected to implement CRS 2.0 by 2029, covering information relating to the 2028 tax year, we believe the tax related overhang could continue to weigh on wealth effects.

A negative read-through for HK talent attraction and residential market

The expert noted that overseas rental income and capital gains earned by mainland residents are subject to a 20% tax levy, while mainland residents are ultimately responsible for declaring their salaries earned from working overseas. We view this as a negative read-through for Hong Kong talent attraction, as well as residential market. Our China Strategy team has previously written that the new rules could create a near-term overhang for offshore-listed non-SOE companies where major shareholders utilize offshore trust structures, as affected shareholders may need to liquidate part of their holdings to meet their tax obligations. Meanwhile, the one-off tax clawback could dampen spending at the ultra-high end in the near term and the higher dividend tax may disincentivize some controlling shareholders from raising dividends going forward.

Both Chinese and non-Chinese tax residents are in scope under the rules

Under the new framework, transfers of assets into offshore trusts made on or after 1 January 2023 may be regarded as taxable events, with Chinese tax residents potentially subject to a 20% individual income tax on the unrealized gains embedded in the transferred assets. In addition, income and gains generated by the trust throughout its life cycle may also be subject to taxation at a rate of 20%. The rules also extend to non-resident individuals who transfer domestic assets into offshore trusts, as well as arrangements involving assets that are effectively controlled by a Chinese tax resident through an offshore trust structure. Taxpayers are required to correct historical tax positioning of their offshore trust arrangements during a 90-day window ending on 22 Oct 2026, and may be required to make tax payments to achieve compliance.

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Q&A

1. What exactly changed under the new offshore trust tax rules, and who has to pay tax?

The biggest change is that offshore trusts are now subject to much clearer tax rules, removing much of the ambiguity that existed before. For Chinese tax residents, tax can arise at establishment, during the life of the trust, and upon termination.

2. How far back can authorities go when collecting unpaid tax on offshore trusts?

The asset transfer ("loading") stage is generally being reviewed back to 2023, although larger cases may extend further. Income generated during the trust's life can be reviewed for the entire life of the trust, not just the last few years.

3. Are Hong Kong residents subject to the same offshore trust tax rules as mainland tax residents?

Not necessarily. The key distinction is whether the individual is treated as a Chinese tax resident or non-resident. Pure Hong Kong residents with no Chinese tax residency generally face a much lighter tax burden unless Chinese assets are involved.

4. Can investment losses be offset against dividend income within a trust?

No. Trading gains and losses can offset each other, but investment losses cannot be used to offset dividends, interest, or other distribution income. The categories are taxed separately.

5. What are the most effective ways, if any, to reduce the offshore trust tax burden?

There's no easy workaround. Changing dividends into salary or other forms of compensation does not solve the problem and may actually result in higher tax rates.

6. Will the new rules discourage major shareholders from paying dividends?

Probably not. Under the new framework, tax can arise even if income stays inside the trust and is not distributed. Simply retaining profits does not necessarily avoid taxation.

7. What additional tax enforcement could China introduce next?

The direction of travel is clear: more disclosure, more enforcement, and more detailed implementation rules. Areas such as anti-avoidance, CFC rules, and tax clearance procedures are likely to become more formalized.

8. Who qualifies as a Chinese tax resident under current rules?

China looks at factors such as household registration, family ties, economic interests, and physical presence. The rules are far more nuanced than simply counting days spent in China.

9. Will overseas rental income, property gains, and other foreign investments face greater scrutiny?

The expert emphasized that overseas income has always been taxable for Chinese tax residents, and enforcement is becoming increasingly effective through data sharing and financial reporting.

10. How are mainland Chinese working in Hong Kong affected by these reporting and tax obligations?

They remain responsible for complying with China tax rules. State-owned enterprises may help manage reporting, but individuals working independently are ultimately responsible for self-declaration.

11. Can Chinese passport holders living overseas avoid Chinese tax residency by spending little time in China?

Not automatically. Having a Chinese household registration, family connections, or economic interests in China may still result in Chinese tax residency despite limited physical presence.

12. How large is the current offshore trust tax recovery campaign?

The campaign appears significant, with cases ranging from hundreds of thousands HKD to billions in tax exposure. The expert noted that cases have already surfaced across multiple provinces and jurisdictions.

13. Are trusts established before 2023 still exposed to retrospective taxation?

Yes. While the transfer of assets into a trust is generally reviewed over a limited period, income generated over the trust's entire history may still be subject to review and taxation.

14. How are mixed China/Hong Kong assets treated when determining China-source exposure?

This remains a grey area. However, if a large portion of the underlying value is derived from Chinese real estate or Chinese assets, authorities may still classify it as China-sourced.

15. What options exist for taxpayers who cannot afford the tax bill before the deadline?

The options appear limited. Outside a few specific scenarios, taxpayers who miss payment deadlines may face ongoing late-payment charges until the liability is settled.

16. Does spending more than 183 days in China automatically trigger tax residency?

For non-domiciled individuals, spending more than 183 days in China can make them Chinese tax residents for that year. However, broader tax obligations depend on their longer-term residency profile.

17. Are unrealized investment gains inside a trust taxable?

No. Tax is generally based on realized gains and actual income received. Paper profits and losses that have not been crystallized are not counted.

18. Is relocating to Hong Kong still an effective tax-residency planning strategy?

Hong Kong remains highly attractive, but simply obtaining residency is no longer enough. Tax residency planning now requires genuine relocation of one's life, family, and economic interests.

19. Can someone truly exit Chinese tax residency while retaining substantial business interests in China?

It has become much harder. If a person's primary economic interests remain in China, authorities may still regard them as having strong Chinese tax connections.

20. Do China-linked investments such as A-shares create ongoing China tax exposure?

Potentially yes. Direct ownership of Chinese assets or Chinese-listed companies increases the risk that authorities view those investments as China-sourced economic interests.

21. How will CRS 2.0 change tax reporting and enforcement?

The trend is toward much fuller disclosure and fewer reporting loopholes. Individuals with multiple tax residencies may eventually need to declare all relevant jurisdictions rather than choose only one.

Valuation Method and Risk Statement

For the various companies across the industries we cover in Hong Kong's stock market, we use a variety of valuation approaches, including DCF models, Gordon growth model analysis and relative valuation analysis using various multiples such as PE, EV/EBITDA and P/BV.
We believe the risks of investing in Hong Kong equities include, but are not limited to: 1) changes in macroeconomic conditions in Hong Kong and China; 2) changes in the interest rate environment in the US; 3) regulatory and political risks.

