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# CHINA

## International Estate Planning Guide

Individual Tax and Private Client Committee

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## I. Wills and Disability Planning Documents

### A. Will Formalities and Enforceability of Foreign Wills

#### 1. Applicable Laws

In the People's Republic of China (PRC), the main governing law for will issues is the "Law of Succession of the People's Republic of China."

#### 2. Legal Capacity

##### a. Being a Testator

Based on Article 22 of the Law of Succession of the People's Republic of China (LoS), wills made by persons with no civil capacity, or with a limited civil capacity, shall be void. For a will to be legally effective, the testator must possess full civil capacity.

According to the General Principle of the Civil Law of the People's Republic of China, the legal requirements for full civil capacity are as follows:

- A citizen aged 18 or over. For a citizen who has reached the age of 16 but not yet the age of 18, if his or her main source of income results from his own labour, he shall be regarded as a person with full civil capacity.
- The mental status of this person is healthy.

##### b. Serving as a Witness

Many types of wills require a witness. In accordance with Article 18 of the LoS, the following persons may not act as a witness to attest a will:

- Persons with no civil capacity or with limited civil capacity;
- Heirs and legatees; and
- Persons whose interests are related to those of the heirs and legatees. (The creditors/debtors/partners of the heirs/legatees shall be also regarded as persons whose interests are related to the heirs and legatees.)

#### 3. The Formality of a Will

A will can only be legitimately produced by one of the following methods:

##### a. Notarized Will

A notarized will is a will made by a testator through a notary office. If a testator wishes to make a notarized will, then the notary office shall review the relevant property certificates mentioned in the will, such as real estate ownership certificates.

##### b. Testator-Written Will

A testator-written will is a will made in the testator's own handwriting and signed by the testator, specifying the effective date of the will.

c. Dictated Will

A dictated will is a will written on behalf of a testator, which must be witnessed by at least two witnesses, one of whom writes the will specifying the effective date of the will with the witness of the other witness (or witnesses), and contains the signatures of the testator and all the witnesses.

In accordance with the LoS, the establishment of a dictated will legally requires at least two witnesses to witness the whole process. One of the witnesses must write down the dictated will according to the testator's oral statement, specifying the date of the will. This dictated will must then be signed by all the witnesses and the testator.

d. Oral Will

An oral will is a will made in the form of an audio recording by the testator. This type of will must be witnessed by at least two witnesses.

e. Nuncupative Will

According to the Law of Succession of the People's Republic of China, a testator may, in an emergency situation, make a nuncupative will which must be witnessed by at least two witnesses. If the emergency situation is resolved, and if the testator is able to make a handwritten or oral will, the testator shall make a handwritten or oral will, and the former nuncupative will shall be declared invalid. If the testator fails to make a handwritten or oral will while he is capable of doing so after the emergency situation is resolved, the nuncupative will made by the testator is automatically invalidated.

4. The Enforceability of Foreign Wills

a. Determination of Lex Causae

To determine the enforceability of a foreign will, the first step is to determine the lex causae for the foreign will.

In accordance with Article 36 of the LoS, for inheritance by a Chinese citizen of an estate outside the People's Republic of China, or of an estate of a foreigner within the People's Republic of China, the law of the place of domicile of the decedent shall apply in the case of movable property. In the case of immovable property, the law of the place where the property is located shall apply.

For inheritance by a foreigner with an estate within the People's Republic of China, or of an estate of a Chinese citizen outside the People's Republic of China, the law of the place of domicile of the decedent shall apply in the case of movable property. In the case of immovable property, the law of the place where the property is located shall apply.

Where treaties or agreements exist between the People's Republic of China and foreign countries, matters of inheritance shall be handled in accordance with such treaties or agreements.

b. Lex Causae and PRC Law

If the lex causae is PRC law, a foreign will shall be void under the following circumstances:

- A will made by a person with no civil capacity, or limited civil capacity;
- A will which cannot manifest the genuine intention of the testator, or made by a testator under duress, or as a result of fraud; or
- A will which has been forged.

Where a will has been tampered with, the affected part shall be void. Other than the above-listed situations, a foreign will shall normally be enforceable if the *lex causae* is PRC law. It should also be noted that for a foreign will to be enforceable in the PRC, the will must be notarized by a notary office in the foreign country, and authenticated by the PRC embassy or consulate in that country. Sometimes, a kinship certificate is also required by the PRC competent authorities in order to enforce the foreign will.

### c. Lex Causae and Foreign Law

If the *lex causae* is foreign law a will must first be valid under foreign law and go through the foreign country's succession procedures to ensure the validity of the foreign will. If the foreign will is invalid under a foreign country's laws, then it cannot be enforced in the PRC. Furthermore, provided the foreign will is valid according to foreign law, the will must be notarized in that country and authenticated by a local PRC embassy or consulate.

#### B. Will Substitutes (Revocable Trusts or Entities)

In accordance with the LoS, there are no applicable will substitutes such as revocable trusts or entities.

## II. Estate Administration

### A. Overview of Administration Procedures

#### 1. Person in Charge of the Estate

Current PRC legislation on estate administration is lacking compared to neighboring areas. Unlike in Hong Kong or Taiwan, no specific regulations have been directly established in the area of estate administration. Estate preservation and execution is similar in function to estate administration.

According to Art. 24 of the LoS, anyone who has in his or her possession the property of a decedent is defined as an estate preserver and shall take care of the property. An estate preserver can be determined as follows:

#### a. Estate Not in the Possession of the Decedent

Following a succession, a person who possesses property of the estate should be responsible for the safekeeping of the estate. If the person lacks civil capacity, is mentally ill or is a minor, their legal representative shall act as custodian of the estate.

The safekeeping of an estate is not only the right, but also the obligation of the person who possesses the estate. Even if the successor renounces his or her rights to inheritance, the estate preserver shall continue to fulfill his or her responsibility.

#### b. Estate in the Possession of the Decedent

No laws clearly stipulate who should take charge of the estate in cases where the estate is possessed by the decedent. Most PRC scholars believe that a successor with knowledge of the death of a decedent, or an executor named in a valid will should be in charge of preserving the estate.

If all of the successors have knowledge of the death of the decedent, all the successors or the estate executors named by the successors shall collectively take responsibility for the estate. The organization (such as enterprise, manufacturer, state institution, etc.) to which the decedent belonged to before his or her death, or the residents or village committee at his or her place of residence shall take charge of the estate under one of the following circumstances:

- None of the successors have knowledge of the death of the decedent
- The successor is a minor or mentally ill
- There is no successor or testamentary executor
- The testamentary executor has no knowledge of the death of the decedent

## 2. Estate Executor Responsibilities

The rights and obligations of an estate executor are not clearly specified in the LoS. However, in judicial practice, the main tasks of the estate executor are as follows:

- To ascertain whether a will is lawful and authentic through the probate process. If a testamentary instrument is not legally valid, it cannot be executed
- To gather all the successors and publicize the contents of the testamentary instrument
- To make a list concerning the name, amount, place and value of property of the estate to identify the scope of the estate and transfer the list to the successors and stakeholders
- To eliminate any obstructions which hinder the execution of the estate, and to request a court order to remove any impediments when necessary
- To distribute property (transfer asset titles to heirs) in accordance with the will of the deceased or the laws

## 3. Obligation of Notice

After the opening of a succession, a successor who has knowledge of the death of the decedent should promptly notify the other successors and the testamentary executor. If none of the successors know about the death of the decedent, or if there is no way to make the notification, the organization to which the decedent belonged before his death or the residents or village committee at his place of residence shall take charge of the estate, according to Art. 23 of the LoS.

There are, however, no provisions stipulating how the notification should be made. In normal practice, notification is done in writing, oral recording, public announcement, telephone, telegram, or email.

## 4. Liquidation of Debts

The successor to an estate shall pay all taxes and debts payable by the decedent up to the actual value of the estate, unless the successor pays voluntarily in excess of the limit. The successor who disclaims inheritance assumes no responsibility for the payment of taxes and debts payable by the decedent. (Arts. 33 and 34 of the LoS). The carrying out of a legacy shall not affect the payment of taxes and debts payable by the decedent.

After an estate is allocated, where statutory succession, testamentary succession and legacy simultaneously exist, taxes and debts payable by the decedent shall first be liquidated by the forced heir. Where the assets of statutory succession can not pay off the taxes and debts, the remaining debts shall be liquidated by testamentary inheritor and legatee in proportion of the estate the heir acquired.

## B. Intestate Succession and Forced Heirs

### 1. Overview of the Succession Regime

Testamentary succession in the PRC generally applies to forced heirs. If no valid will or legacy exists, the estate should be dealt with in accordance with the provisions of statutory succession, which are governed by the Law of Succession of the People's Republic of China.

### 2. Forced Heirship

#### a. Order of the Succession

According to Art. 10 of the LoS the estate of the decedent shall be inherited in the following order:

- i. First in order: spouse, children, parents.
- ii. Second in order: siblings, paternal grandparents, maternal grandparents. When succession opens, the successor(s) first in order shall inherit to the exclusion of the successor(s) second in order. The successors second in order shall inherit by default of any successor first in order.

"Children" include both legitimate and illegitimate children, adopted children, and stepchildren who supported or were supported by the decedent.

"Parents" include natural and adoptive parents, as well as step parents who supported or were supported by the decedent.

"Siblings" includes both blood and half siblings, adopted siblings, as well as step siblings who supported or were supported by the decedent.

### 3. Forfeiture of Inheritance

Cases where the heir forfeits his right to inherit are listed in Art. 7 of the LoS and are limited to: intentional killing of the decedent; a serious act of abandoning or maltreating the decedent; a serious act of forging, tampering with, or destroying of the will; and killing any other successor in a dispute over the estate.

### 4. Estate Dealt as Statutory Succession

Under any of the following circumstances the part of the estate affected shall be dealt with in accordance with statutory succession:

- Where the inheritance is disclaimed by a testamentary inheritor or the legacy is disclaimed by a legatee;
- Where a testamentary inheritor is disinherited;
- Where a testamentary inheritor legatee predeceases the testator;
- Where an invalidated portion of the will involves part of the estate; or

- Where no disposition is made under the will for part of the estate.

## 5. Determining the Shares of the Decedent's Assets

Successors in the same order shall generally inherit equal shares of an estate's assets. In cases where a successor is unable to work and has special financial difficulties, he or she shall acquire a share of the decedent's due consideration while distributing the estate. Successors who have made predominant contributions in maintaining the decedent or have lived with the decedent may be given a larger share while distributing the estate. Successors who had the ability and were in a position to maintain the decedent but failed to fulfill their duties shall be given no share, or a smaller share of the estate.

An appropriate share of the estate may be given to a person, other than a successor, who depends on the support of the decedent and who neither can work nor has a source of income. An appropriate share can also be given to a person other than a successor who was largely responsible for supporting the decedent.

### C. Marital Property

#### 1. Overview of Marital Property Regimes in the PRC

Marital property regimes in the PRC are mainly divided into jointly owned property and separately owned property. Prenuptial agreements have been traditionally frowned upon in Chinese culture, but because of an increased awareness of personal assets, more and more couples are accepting the notion of the division of premarital property.

In the course of a marriage, a couple may also produce an agreement to clarify which parts of their property are jointly owned, and which shall constitute separate ownership. This agreement shall be made in written form. Notarization of such an agreement is recommended but not compulsory.

Where an aforementioned agreement is lacking, or the provisions in the agreement are not clear, the provisions of Art. 17 and 18 of the PRC Marriage Law (LoM) shall apply to determine the jointly and separately owned properties.

#### 2. Partitioning the Decedent's Estate

Art. 26 of the LoS provides that while partitioning a decedent's estate, unless otherwise agreed upon, half of the joint property acquired by a spouse in the course of a marriage shall be first allotted to the surviving spouse as his or her own property. The remainder constitutes the decedent's estate.

If the decedent's estate is a component part of the common property of the whole family, that portion of the property belonging to the other members of the family shall first be separated at the time the property is partitioned.

#### 3. Determination of Jointly and Separately Owned Property

Where a spouse passes away without leaving a will, the following rules shall distinguish jointly owned property from separately owned property:

##### a. Jointly Owned Property

The following property acquired by both spouses in the course of their matrimonial life shall be dealt with as joint property, in accordance with Art. 17 of the LoM:

- Wages and bonuses

- The proceeds of business and production operations
- Intellectual property right incomes
- Property acquired from inheritances or presentations, with the exception of such property as stipulated by the provisions of the third item of Art. 18 of the LoM
- Other property which should be in joint possession

The last mentioned “other property” can, for example, include any proceeds that are generated after marriage from the separately owned property of a spouse (excluding fruits and unearned increment) and shall be determined as community property, according to Art. 5 of Interpretation of the People’s Supreme Court on Certain Issues Concerning the Application of the “Marriage Law”.

#### b. Separately Owned Property

Property in the following cases shall belong to one party of the couple according to Art. 18 of the LoM:

- Property that belongs to one party before marriage
- Payments for medical expenses received by one party who suffers physical injury, subsidies for living expenses granted to the disabled, etc.
- Property in the possession of one party as determined by will or by an agreement or gift
- Articles for daily use, especially used by one party, and
- Other property which should be in possession of one party

#### 4. Specific Regulations Regarding Immovable Property

The recent rapid growth in the value of immovable property in China has brought an increase in marriage-related property disputes. In 2012, the People’s Supreme Court defined Art. 7 of Interpretation III of the LoM as follows:

- Where after marriage, immovable property is purchased by the parents of one spouse, if the property ownership thereof is registered under the name of the child of the investors, such property may be deemed as a gift only to the investor’s child, and shall be determined as a separately owned property of the concerned spouse.
- Where the immovable property is purchased using funds from the parents of both parties, if the property ownership thereof is registered under the name of one party, such immovable property may be determined to be owned by the parties in proportion to their respective parents’ share in capital contribution, unless otherwise agreed upon by the parties.

#### D. Tenancies, Survivorship Accounts, and Payable on Death Accounts

##### 1. Tenancies

During the tenancies, the original housing lease contract shall continue to take effect if the housing is transferred due to an inheritance. If a tenant dies during tenancy, the person living with the tenant when

he or she was alive may lease the housing in accordance with the original lease contract, according to Art. 12 of Administrative Measures for the Leasing of Commodity Housing.

## 2. Survivorship Accounts

The concept of survivorship accounts is not common in the PRC. Banks do not provide these types of accounts to manage the assets of the decedents. Accounts that deal with a decedent's assets are usually used according to the instructions of the will or the estate executor.

## 3. Payable on Death Accounts

As with survivorship accounts, the concept of a payable on death account is also not common in the PRC. Banks do not provide these types of accounts to manage a decedent's assets. The account to deal with a decedent's assets is usually used according to the instructions of the will or the estate executor.

### III. Trust, Foundations, and Other Planning Structures

#### A. Common Techniques

##### 1. Trusts

According to PRC Trust Law (TL), a trust refers to that of the settlor, based on his or her faith in the trustee, entrusting his or her property rights to the trustee and allowing the trustee to, according to the will of the settlor and in the name of the trustee, administer or dispose of such property in the interest of a beneficiary or for any intended purposes.

Where a trust is created in the form of a trust contract, the trust shall be deemed created when the said contract is signed. Where a trust is created in any other form of writing, the trust is deemed created when the trustee accepts the trust.

##### 2. Legal Requirements for Establishing a Trust

A trust can be created only for lawful trust purposes. There must be definite property under the trust, and such property must be property lawfully owned by the settler. A trust must be in writing, and contain trust contracts, testaments, or other documents specified by law and administrative regulations.

The following items shall be stated clearly in the written documents required for the creation of a trust:

- a. Purposes of the trust
- b. The names and addresses of the settlor and trustee
- c. The beneficiary or beneficiaries
- d. The scope, types and status of the assets under the trust
- e. The form and means through which the beneficiary gains benefits from the trust

In addition to the items mentioned above, the period of the trust, the methods for the administration of the property under the trust, remuneration payable to the trustee, manner for appointing another trustee, the cause for termination of the trust, etc., shall be stated clearly.

Where laws or administrative regulations require registration formalities for the creation of a trust, these formalities shall be adhered to accordingly.

### 3. Invalid Trusts

In accordance with the TL, a trust shall be deemed invalid under the following circumstances:

- a. The purpose of the trust constitutes a violation of laws or administrative regulations, or impairs public interest
- b. The property under the trust cannot be fixed
- c. The settlor creates the trust with unlawful property or with property which, according to law, may not be used for creating a trust
- d. The trust is created specially for the purpose of taking legal actions or for recovering debts
- e. The beneficiary or beneficiaries cannot be determined
- f. Other circumstances stipulated by law or administrative regulation

### 4. Testamentary Trusts in the PRC

The TL offers a basic legal structure for trusts. It clearly states that a testamentary trust is one category of trusts permitted by law. Article 13 of the TL provides that for the creation of a testamentary trust, the provisions in the LoS shall be observed. China's rapid economic development as well as the rapid accumulation of family wealth has provided great opportunities and challenges for the development of trusts in China. In recent years, trust companies and their trust products have been heatedly discussed and drawn the attention of both the general public and the wealthy class. Nevertheless, even against such a background, testamentary trusts are still a blank area in China. The reasons are as follows:

#### a. The Financial License System

According to Article 7 of Measures for Administration of Trust Companies, the establishment of a trust company shall be approved by the China Banking Regulatory Commission and a financial license shall be obtained. Without prior approval from the China Banking Regulatory Commission, no unit or individual may engage in a trust business, and no operating unit is permitted to use the phrase "trust company" in its name, unless otherwise provided by law.

Although Article 24 of the TL provides that a natural person can become a trustee, in practice, a natural person trustee is very rare. The financial license system imposes strict restrictions on the qualifications of trust companies. According to the latest government statistics, there are only 70 trust companies with financial licenses in China, as of January 2013.

#### b. Few Trust Companies Provide Testamentary Trusts

Few trust companies provide testamentary trust services in China. This is due to various factors, such as the lack of a systematic and well-developed legal system regarding trusts. For instance, a single tax system is applicable in countries such as the UK, U.S. and Japan. In the PRC, however, there are no accurate provisions on the taxing of trust products under the current tax system in China. In addition, the PRC Administration for Industry and Commerce also lacks clear guidance on the registration of trusts. Government policy is also a concern, and without positive guidance and encouragement from the government, most trust companies would not innovate new trust products such as testamentary trusts.

### c. Reserved Portions

Under the LoS, reservation of a necessary portion of an estate shall be made in a will for a successor who neither can work nor has a source of income.

Furthermore, it is stipulated that at the time of the partitioning of the estate, the reserved portion shall be made for the share of an unborn child. The share reserved shall, if the baby is stillborn, be dealt with in accordance with statutory succession.

## 5. Foundations

In other countries and areas of the world, a foundation is another estate planning structure. China's situation, however, is different. In accordance with PRC Regulations on Administration of Foundations, a foundation must be established for a specific public welfare purpose. Furthermore, it is stipulated that the annual expenditure on public welfare undertakings shall not be less than 70 percent of the total revenue collected in the previous year. Hence, a foundation established by endowment from a will is not applicable for estate planning purposes.

### B. Fiduciary Duties (Trustees, Board Members, Directors, etc.)

#### 1. Trustees

The trustee shall be a natural person or legal person with full civil capacity. Under PRC Trust Law, a trustee shall owe the following fiduciary duties to the settlor:

- The trustee shall abide by the provisions in the trust documents and handle the trust business for the best interests of the beneficiary. In administering the trust property, the trustee shall be careful in performing his or her duties, and fulfill his or her obligations honestly, in good faith, and in a prudent and efficient manner;
- Except obtaining remuneration according to the provisions of PRC Trust Law, the trustee shall not seek interests for himself or herself by using the trust property;
- The trustee shall not convert the trust property into his own property;
- The trustee shall not conduct internal transactions between his or her own property and the trust assets, or between the trust assets of a different settlor unless it is otherwise stipulated in the trust documents or is consented by the settlor or beneficiary and the internal transaction is conducted at a fair market price;
- The trustee shall administer the trust property separately from his or her own property and keep separate accounting books;
- The trustee shall handle the trust business himself, but may entrust another person to handle such affairs on his behalf where the trust documents provide otherwise or he/she has to do so for reasons beyond their control.

#### 2. Directors of a Foundation

As previously mentioned, a foundation fails to meet the purposes of estate planning under PRC law.

### C. Treatment of Foreign Trusts and Foundations

There are no special laws or regulations regarding foreign trusts and foundations. Foreign trusts and foundations are not a common method for estate planning in mainland China.

## IV. Taxation

### A. Domicile and Residency

#### 1. General Rules

In accordance with Art. 1 of the Law of PRC on Individual Income Tax (ITT), individuals under the following two circumstances shall file individual income taxes:

- Individuals domiciled in the PRC, or individuals who have no domicile in China but have resided in the country for one year or more, shall pay individual income tax on income earned within or outside China;
- Individuals who have no domicile and do not reside in the PRC, or who have no domicile but have resided in China for less than one year shall pay individual income tax on their income earned within China.

#### 2. Rules for Foreign Nationals

Foreign nationals who have resided in China less than five years shall only pay tax on income sourced from China, which is subject to the ITT in China. Foreign nationals who have resided in China more than five consecutive years are taxable on worldwide income commencing the sixth year of residence.

For a foreign national who stays in China less than 90 days (or 183 days in cases where there is a bilateral tax treaty) in one calendar year, he or she is only liable for tax on China-sourced income (income related to his or her employment in China and born by a Chinese entity). This rule, however, does not apply for directors or senior management personnel. Foreign directors and senior management personnel are liable for tax on China-related and worldwide sourced income no matter how long they stay in China in a calendar year.

If a foreign national stays for more than 90 days (or 183 days in cases where there is a bilateral tax treaty) in a calendar year in China, he or she is liable for tax on China-related and worldwide-sourced income.

### B. Gift, Estate, and Inheritance Taxes

There are currently no laws covering estate and gift taxes. The Interim Provisions of Estate Tax was drafted in 2004, but has not yet become effective. During the 18th National People's Congress in 2012, the deputies to the people's congress (China's legislature) proposed to consider the draft provisions in their agenda. When and whether estate and gift taxes will be implemented in the PRC is unknown, but their introduction would potentially have a strong impact on the country, especially among the wealthier class.

A deed tax shall be paid if the ownership of land and houses is to be transferred within the territory of the PRC, according to the Interim Regulations of the PRC on the Deed Tax. There is currently no inheritance tax system in the PRC.

Forced heirs (spouse, children, parents, siblings, grandparents) do not need to pay deed taxes. Where the inheritor named under a will is not a forced heir, he or she shall pay the deed tax while inheriting the land and house of the decedent.

The formula for the calculation of the deed tax amount payable is as follows:

$$\text{Tax Amount Payable} = \text{Base for Tax Calculation} \times \text{Tax Rate 3.5 percent}$$

The following bases are used to calculate the deed tax, which is regulated in Art. 4 of the Interim Regulations of the PRC on the Deed Tax:

- For assignment of the right to use state-owned land, the sale of land use rights or the purchase and sale of houses, the base shall be the transaction price;
- For gift of the land use right or of a house, the base shall be determined by the collection agency with reference to the market price for the sale of the land use right or the purchase and sale of the house; and
- For exchange of the land use right or of a house, the base shall be the price difference between the exchanged land use rights or the houses, respectively.

If the purchase price mentioned in the preceding paragraph is obviously lower than the market price without justification or if the price difference for the exchanged land use right or houses is obviously unreasonable without justification, the base shall be determined by the collection agency with reference to the market price.

The deed tax amount rate is 3.5 percent, determined by the governments of provinces, autonomous regions or municipalities. The tax amount should be paid in RMB.

### C. Taxes on Income and Capital

#### 1. Subject to Taxes Payment

Individual income tax shall be paid on income from the transfer of property, according to Art. 2 (9) of the Law of PRC on Individual Income Tax. Regarding voluntary gifts of the ownership of immovable property, taxes on individual income shall not be paid under the following circumstances:

- a. The ownership of the immovable property is gratuitously transferred to the spouse, parents, children, siblings, paternal grandparents, maternal grandparents, or grandchildren;
- b. The ownership of the immovable property is granted to the person who made the predominant contributions in maintaining the donor;
- c. Where the owner of the immovable property dies, the forced heir, testamentary inheritor and legatee acquire the ownership of the immovable property.

Apart from the aforesaid, the donee shall pay taxes on “income from other sources specified as taxable by the department of finance under the State Council.”

#### 2. Computation

The formula for the calculation of the tax amount payable is as follows:

Tax Amount Payable = (The price of the house stated in the gift contract - the expenses and taxation resulted from the title transfer) x Tax Rate 20%.

In the formula the taxation may include for example the stamp duty, inheritance notary and registry fees and deed tax.

\* \* \* \* \*

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