
China offices

Legal flash

2021 – YEAR IN REVIEW



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Legal regulations: 2021 update

In 2021, China made remarkable progress in legislation. In the area of data security, the long-awaited Data Security Law and Personal Information Protection Law were adopted, making it the first comprehensive legislation to address the emerging challenges to data and personal information security. In the area of dispute resolution, the draft Arbitration Law was released for public comment, proposing significant changes to the arbitration regime. In commercial law, the draft Amendment to the Company Law was also published for public comment.

Below we summarize the most significant developments of 2021.

Data protection

Data Security Law

On June 10, 2021, the Standing Committee of the 13th National People's Congress passed the **Data Security Law** ("DSL"), which became effective on September 1, 2021.

Highlights

- Data categories and hierarchies: The DSL establishes a data categorization and hierarchical protection system, under which stricter regulations apply to the **national core data**, which concerns national and economic security, significant public interests, and citizens' welfare, and **important data**, which has not yet been defined.
- Catalogues for important data: Local governments and industry sectors are authorized to issue region- and industry-specific catalogues for important data.
- Data security review system: The DSL establishes a data security review system, under which data-processing activities that affect—or may affect—national security must be reviewed.
- Data processors' obligations: The DSL imposes general data security compliance obligations on data processors. They must establish data security management systems throughout the whole process, organize data security training, and take corresponding technical measures and other necessary measures to guarantee data security. Processors who carry out data-processing activities through information networks (e.g., the internet) must follow the existing classified protection scheme for network security (as



established by the Cybersecurity Law). Data processors must inform users of all data security incidents and report them to regulators.

- Obligations of processors of important data: The processors of important data are required to identify the management body and person responsible for data security protection and periodically carry out risk assessments on their data-processing activities and file risk assessment reports to the competent authority.
- Crossborder transfer of important data: For critical information infrastructure operators (“CIIOs”), the crossborder transfer of important data must be carried out in compliance with the Cybersecurity Law (“CSL”). For other entities, it must be carried out in compliance with the regulations to be formulated by the Cyberspace Administration of China (“CAC”) and the pertinent departments of the State Council.

Personal Information Protection Law

On August 20, 2021, the Standing Committee of the 13th National People’s Congress passed the **Personal Information Protection Law** (the “PIPL”), which came into effect on November 1, 2021.

Highlights

- Applicability: As with the European Union’s General Data Protection Regulation (“GDPR”), PIPL has extraterritorial reach over certain processing activities carried out outside China that involve data subjects located in China, especially when the purpose of the activity is to (i) provide a product or service to an individual located in China, or (ii) analyze or assess the behavior of an individual located in China. Foreign processors to which the PIPL applies must establish a special agency or appoint a local representative in China to handle compliance-related affairs.
- Processing principles: Under the PIPL, personal information must be processed according to the principles of lawfulness, fairness, necessity and good faith, purpose limitation and data minimization, publicity and transparency (i.e., the purpose, method and scope of the processing must be clearly indicated), accuracy, accountability, and data security.
- Legal bases of processing: The PIPL establishes several legal bases for processing personal information, especially the following:



- (i) Consent: For certain processing activities, separate consent is required; e.g., to process sensitive personal information, provide personal information to third parties, publish personal information, or transfer personal information on a crossborder basis.
 - (ii) When necessary to (a) enter and perform a contract to which the individual is a party, or (b) implement human resources management under legally formulated internal labor rules.
- Notification requirements: Before processing information, the personal information processor must provide certain information, including (i) processor's name and contact information; (ii) the purpose for processing the information and the methods used; (iii) the types of personal information being processed and the storage period; and (iv) the methods and procedures through which individuals can exercise their rights under the PIPL. When sensitive personal information is involved, the necessity of processing that sensitive information, as well as its effect on the individual's rights and interests, must also be indicated.
 - Data processors' obligations: Under the PIPL, data processors, in addition to complying with other obligations, must formulate internal management policies and procedures, implement security measures (such as encryption and depersonalization), and implement response plans for personal information security incidents.
 - Crossborder transfer of personal information: Under the PIPL, to carry out the crossborder transfer of personal information for business reasons, one of three requirements must be met, which are:
 - (i) passing the security assessment organized by the CAC;
 - (ii) obtaining personal information protection certification from a professional agency; or
 - (iii) entering into a contract with the overseas recipient following the standard contract formulated by CAC, which is yet to issue it.
 - Other requirements: The PIPL also establishes an obligation to carry out a so-called personal information impact assessment in certain circumstances. It also imposes specific obligations on certain types of businesses, such as CIIOs or personal information



processors that reach the personal information processing threshold established by the CAC (yet to be issued).

The PIPL, CSL and DSL together form a three-pillar framework for China's cybersecurity and data protection regime.

Dispute resolution: draft revised Arbitration Law

On July 30, 2021, China's Ministry of Justice issued the draft revised Arbitration Law ("Draft Arbitration Law") for public comment. The current Arbitration Law was promulgated in 1994, and it was further amended in 2009 and 2017.

Most significant developments in Draft Arbitration Law

> Arbitrators and arbitral institutions

- ✓ Improves the existing qualifications of arbitrator by adding an exhaustive negative-list provision
- ✓ Respects parties' right and freedom to appoint arbitrators from arbitral institution panels of "recommended arbitrators"
- ✓ Establishes a unified registration system for arbitral institutions

> Arbitral agreement

- ✓ A fundamental change has been implemented to what constitutes a valid arbitration agreement by only requiring parties to "have the intention to resolve the dispute through arbitration." The parties are no longer required to agree on the arbitral institution.
- ✓ It is yet to be clarified whether domestic parties' agreement to submit the dispute that does not have foreign-related elements to an offshore arbitration institution or to carry out *ad hoc* arbitration abroad is valid. Based on current practice, the people's courts must consider this type of arbitration agreement invalid.



- Seat of arbitration
 - ✓ Parties may agree on the seat or place of arbitration. If there is no agreement or the agreement is unclear about the seat, the place of arbitration will be the seat of the arbitral institution administering the case.
 - ✓ Follows the international practice of recognizing the nationality of an arbitral award according to the seat of arbitration.
 - ✓ Further distinguishes the concept of “seat of arbitration” from the place where specific activities in the arbitration proceedings are carried out, such as the “place of hearings,” and clarifies the difference between the two.
- Interim measures and preservation
 - ✓ Consolidates the existing preservations with other interim measures, and adds the conduct preservation and emergency arbitrator mechanisms.
 - ✓ Clarifies that the arbitral tribunal has the power to decide on interim measures.
 - ✓ If the interim measures need to be enforced outside the territory of China, the parties may apply directly to a foreign court with jurisdiction to enforce them.
- Other measures that enhance the international credibility and competitiveness of China as a seat of international arbitration
 - ✓ The restrictive expression “equal subjects” has been removed to facilitate investor-state arbitration and sports arbitration in China. This will remove the legal obstacles for China’s arbitration institutions to administer these international disputes.
 - ✓ Adopts the *kompetenz-kompetenz* (competence-competence) principle.
 - ✓ Clearly establishes that the arbitral proceedings can be held online.



Draft Amendment to the Company Law

On December 24, 2021, the Standing Committee of the 13th National People's Congress issued the draft Amendment to the Company Law ("Draft Company Law Amendment"), which significantly amends the current Company Law, for public comment.

Highlights

- Capital contribution by equity and creditors' rights: Article 43 confirms that shareholders can make capital contributions through equity and creditors' rights that may be valued in monetary term.
- Legal consequences in case of defect in capital contribution
 - ✓ If a shareholder, following the formation of a limited liability company, does not make the capital contributions in full or in time or the actual value of the non-monetary property used as capital contributions is clearly lower than the amount of the capital contribution to which the shareholder subscribed, (i) that shareholder must make up the difference and pay the interest, and will have to pay compensation if the company suffers any losses; (ii) other shareholders of the limited liability company will be jointly and severally liable; and (iii) the director, supervisor and senior management will be liable to the company for any losses if they were aware—or should have been aware—of the situation but did not take the necessary actions.
 - ✓ Loss of equity: If a shareholder does not make capital contributions in the full amount in time or the actual value of the non-monetary property used as a capital contribution is clearly lower than the amount of capital contributions to which the shareholder subscribed, and the shareholder fails to do so after the grace period the company requires, that shareholder will lose all unpaid equity.
 - ✓ Capital contributions in advance: Shareholders are entitled to make capital contributions based on the schedule provided in the articles of association of the limited liability company. Under article 48 of the Draft Company Law Amendment, if a limited liability company is unable to pay off its debts and is insolvent, the company or its creditors are entitled to require the shareholders to make the capital contributions in advance.



- Notice of equity transfers: Under article 85 of the Draft Company Law Amendment, the requirement to obtain the consent of other shareholders to carry out equity transfers no longer applies, with only the pre-emptive right remaining. If equity in a limited liability company is transferred to a third party, the shareholder who intends to transfer that equity need only (i) send a notification to the other shareholders, and (ii) give them the opportunity to exercise their preemptive right. If the other shareholders do not respond within a statutory period, the shareholder is free to transfer the equity to the third party.

- Legal consequences of the actions of a company's legal representative toughened: Articles 11, 23 and 28 confirm that the documents for incorporating or changing a company must be signed by its legal representative, and the company must bear the legal consequences arising from the actions the legal representative carries out on the company's behalf.

- Liability of shareholders, directors and senior management strengthened:
 - ✓ Article 183 broadens the definition of related-party transactions between directors, supervisors and senior management with the company, imposing a reporting obligation and voting recusal mechanism.

 - ✓ In addition to other statutory obligations, articles 190 and 191 establish that (i) the director and senior management must bear joint liability with the company if they cause damage to others intentionally or due to their gross negligence while carrying out their duties; and (ii) the controlling shareholder or actual controller must bear joint liability if it takes advantage of its influence in the company and encourages the director and senior management to carry out activities that damage the interests of the company or the shareholders, who suffer losses as a consequence.



Tax regulations: 2021 update

Although the COVID-19 pandemic continued in 2021, life gradually returned to relative normality. In the meantime, progress was made in tax legislation, both domestically and internationally. In this special edition, we review several important tax regulations from 2021.

On December 31, 2021, the Ministry of Finance and the State Taxation Administration confirmed that several key **individual income tax** preferential policies scheduled to be abolished by December 31, 2021, will be extended, including the following:

- Policy on tax-exempt benefits for expatriates (e.g., housing rental and children's education fee) extended to the end of 2023
- Preferential tax treatment for annual bonus (the annual bonus is divided by 12 for the applicable tax rate in the converted monthly progressive tax rates applicable to comprehensive income) extended to the end of 2023
- Tax-exempt policy for situations where (i) resident taxpayers' annual comprehensive income is up to RMB 120,000 with the additional tax to be paid through the annual self-declaration, and (ii) additional tax to be paid through the annual self-declaration is up to RMB 400, extended to the end of 2023
- Preferential tax treatment for equity-based incentives of listed companies (resident taxpayers can continue to calculate individual income tax independently on the equity-based incentives obtained from listed companies by applying the progressive tax rates applicable to comprehensive income) extended to the end of 2022

Although the news that the policies would be extended was announced at the last minute, it was well received by the public.

Concerning **enterprise income tax** ("EIT"), several policies on expense deduction are worth mentioning:

- Since January 1, 2018, the research and development ("R&D") expense super deduction rate for enterprises was increased from 50% to 75%, and the tax base for amortizing intangible assets was increased from 150% to 175%. Although this policy was scheduled to expire by the end of 2020, it has been extended to December 31, 2023.



- From January 1, 2021, the R&D expense super deduction rate for manufacturing enterprises was further increased to 100%, and the tax base for amortizing intangible assets was increased to 200%.
- Since January 1, 2018, newly purchased equipment and instruments with a unit value not exceeding RMB 5 million have been allowed a one-time deduction without depreciation when calculating taxable income for EIT purposes. Although this policy was scheduled to expire by the end of 2020, it has been extended to December 31, 2023.

Also, from January 1, 2019, for small enterprises with low profits, the taxable income of up to RMB 1 million was reduced to 25% and taxed at a 20% EIT rate (i.e., an effective tax rate of 5%). From January 1, 2021, this preferential policy was updated, and the taxable income of up to RMB 1 million was further reduced to 12.5% and taxed at a 20% EIT rate (i.e., an effective tax rate of 2.5%). The policy is scheduled to expire on December 31, 2022.

To implement the EIT preferential policy in the Hainan Free Trade Port, in early 2021, the Chinese authorities issued a Catalogue of Encouraged Industries in the Hainan Free Trade Port (2020 version), which is effective from January 1, 2020, to December 31, 2024. The industries included in the catalogue can apply a reduced EIT rate of 15%.

Concerning **value-added tax** (“VAT”), in 2021, the trial electronic VAT special invoice was fully implemented nationwide, and the tax authorities have been intensely investigating cases involving falsifying VAT special invoices.

Several VAT preferential policies have also been updated, including the following:

- Since January 1, 2019, small-scale VAT taxpayers with a monthly revenue of up to RMB 100,000 have been exempt from VAT. From April 1, 2021, this policy was updated by increasing the exemption criteria to RMB 150,000, and it will be effective until December 31, 2022.
- Since June 1, 2019, taxpayers in certain advanced manufacturing industries can apply for a refund of un-deducted input VAT if they meet certain conditions; e.g., the incremental un-deducted input VAT amount must be above zero (compared to RMB 500,000 for regular companies). The scope of advanced manufacturing industries includes “non-metallic mineral products,” “general equipment,” “special equipment,” and “computer, communication and other electronic equipment.” From April 1, 2021, this policy was updated by expanding the scope of advanced manufacturing industries to “pharmaceuticals,” “chemical fibers,” “railway, shipping, aviation, aerospace and other



transportation equipment,” “electrical machinery and equipment,” and “instruments and apparatus.”

- The policy on R&D centers to claim a VAT refund on domestically purchased equipment has been further extended from January 1, 2021, to December 31, 2023.

Also, from January 1, 2022, to December 31, 2025, VAT exemption applies to product liability insurance and product quality guarantee insurance on the export of goods.

Concerning the VAT refund policy, the Government of China canceled the export VAT refund for 146 types of iron and steel products categorized by the HS codes. Those iron and steel products were previously granted VAT refund rates of 13% and 10%. Therefore, before the cancellation, exporters could claim all or most of the input VAT related to producing or purchasing those exported products.

However, following the cancellation, those exported iron and steel products will be treated as domestic sales by applying a 13% VAT rate, resulting in a higher cost for exporters if they cannot shift it to foreign buyers by increasing the price.

In the context of **corporate restructuring**, the exemption policy of deed tax and land VAT is extended for another three years from January 1, 2021, to December 31, 2023, when titles of land and real estate are transferred through corporate restructuring (e.g., a merger, split, or bankruptcy).

In the context of **tax legislation in China**, from September 1, 2021, the new Deed Tax Law and the new City Maintenance and Construction Law became effective.

Also, in 2021, the new Stamp Duty Law was approved by the 29th session of the Standing Committee of the 13th National People’s Congress, becoming effective on July 1, 2022. Although the new law inherits many stipulations under the current regulations, it also makes some important changes, such as the following:

- The taxable items and tax rates are adjusted: (i) the tax rate for processing contracts, construction engineering surveys and design contracts, and cargo transportation contracts has been reduced from 0.05% to 0.03%; (ii) the tax rate for property insurance contracts has been increased from 0.003% to 0.1%; (iii) financial leasing contracts are listed separately with a tax rate of 0.005%; (iv) the tax rate for licensing contracts of trademark, copyright, patent, and technical know-how has been reduced from 0.05% to 0.03%; and (v) stamp duty on certificates has been canceled.



- The tax base does not include VAT if it is listed separately from the contract amount. This is a new provision that was not included in the old regulation.
- An exemption applies to electronic purchase orders between individuals and e-commerce operators. This policy is welcome, as collecting stamp duty on these transactions, in addition to increasing consumers' tax burden, is impractical.
- Concerning tax administration, under the new Stamp Duty Law, if a foreign taxpayer has a domestic agent, that agent may act as the taxpayer's withholding agent. However, if the taxpayer does not have a domestic agent, the taxpayer must make a self-declaration.
- Stamp duty may be declared quarterly, annually, or on a transactional basis.

Concerning **international taxation**, the new double taxation agreement between Spain and China (the "New Spain-China DTA") entered into force on May 2, 2021, except for taxes not withheld at source, the effects of which will arise for tax years beginning May 2, 2021.

The New Spain-China DTA is the outcome of negotiations that began in Beijing in 2015 with the aim of aligning the bilateral taxation framework with the current economic context and the guidelines on international taxation established by the OECD, introducing changes on the provisions of permanent establishment, dividends, capital gains, associated companies, anti-abuse rules, etc. Its entry into force repeals the previous agreement signed in 1990.

For **transfer pricing**, the Chinese authorities also designed a simplified procedure for applying for a unilateral advance pricing arrangement ("APA"), implemented September 1, 2021.

The general procedure for applying for an APA in China—whether unilateral, bilateral, or multilateral (based on the number of tax authorities involved)—involves six steps:

- (i) Pre-filing meeting
- (ii) Letter of intent
- (iii) Analysis and evaluation
- (iv) Formal application
- (v) Negotiation and signing
- (vi) Implementation and monitoring



The simplified procedure cancels the pre-filing meeting step and consolidates the letter of intent, analysis and evaluation, and formal application steps into a single step, meaning the whole process is reduced to only three steps:

- (i) Application and evaluation
- (ii) Negotiation and signing
- (iii) Implementation and monitoring

Companies that want to sign a unilateral APA to increase tax certainty on their related-party transactions may take advantage of the new simplified procedure if they meet the qualifying conditions.

In the area of **tax administration**, to further regulate law enforcement and improve tax administration, the State Taxation Administration modified the Measures for the Trial of Major Tax Cases and released the new Provisions on the Procedures for Handling Tax Inspection Cases.

Also, in response to the amendment of the Administrative Penalty Law in early 2021, the State Taxation Administration released an announcement concerning a list of 10 tax matters that are not subject to a tax administrative penalty when it is a first offense, provided (i) the offense only causes minor harm, and (ii) the taxpayer rectifies the behavior voluntarily before it is identified by the tax authorities or within the period specified by the tax authorities.



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