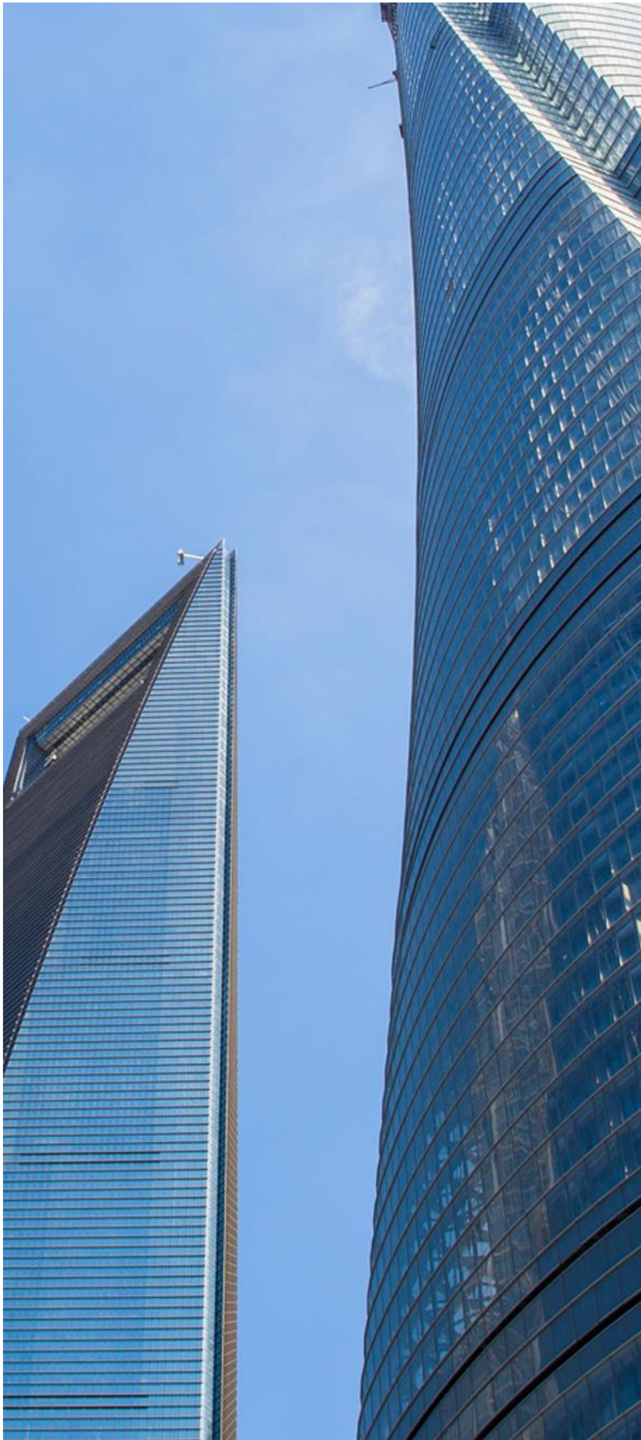
CUATRECASAS

China offices

Legal flash

2018 – YEAR IN REVIEW



Index

- Legal regulations: 2018 update
- Tax regulations: 2018 update

Legal regulations: 2018 update

According to the figures for 2018, China suffered the second consecutive year of decline in outbound investment of domestic enterprises, while the total amount of foreign direct investment continued to slow down with only a 3% increase in 2018. The number of newly established foreign-invested enterprises increased rapidly, around 70% yearly, which implies that the investment volume of the individual foreign investment project has dropped. Chinese legislation has been promoting foreign direct investment and market openness and streamlining institutional reform further to integrate the administration.

This update reviews significant changes that took place in 2018. For more information, see our monthly legal flash editions.

Changes and developments in **general foreign direct investments** include the following:

- In June 2018, the National Development Reform Commission ("NDRC") and the Ministry of Commerce ("MOFCOM") jointly released the regular update to the foreign investment guidelines catalogue (i.e., the List of Industries with Special Foreign Investment Requirements in terms of restricted and prohibited items) and to the list applied in the pilot free trade zones, which became the first unified comparable regime in 2018 based on the national standard classification.

  The most noticeable changes are the opening of sectors in finance, infrastructure, transportation and manufacturing of automobiles, vessels and aircrafts. Foreign automakers and securities, futures and insurance companies can benefit from a step-by-step liberation of shareholding ratio in the coming years. For instance, the shareholding ratio of foreign investors for companies manufacturing special and new energy vehicles was lifted in 2018. This restriction will be lifted for commercial vehicle manufacturers in 2020 and for passenger vehicle manufacturers in 2022, so will be the limit on two joint ventures per foreign investor.

- On July 30, 2018, MOFCOM published a revised draft of the Administrative Measures for Strategic Investment by Foreign Investors in Listed Companies for public comments, which is the first major amendment since it came into effect in 2006. Foreign investors no longer need to hold 10% of the shares issued by the listed company after initial investment, and the lock-up period for their acquired shares is shortened from 3 years to 12 months. For the first time, foreign individuals are considered foreign investors of the listed companies.

- On December 25, 2018, MOFCOM officially announced the Negative List for Market Access, effective January 1, 2019, which applies to all investors. It ended the pilot period started in March 2016.

- Finally, the big news came on December 26, 2018, when the Standing Committee of the National People's Congress ("NPC") reviewed the Draft Foreign Investment Law and published it for public comments. Its final version will replace existing laws on foreign-invested enterprises. The first draft was released in January 2015. The new one reduces the number of clauses from 170 to 39, simplifies the definition of foreign investment and removes monetary fines. These revisions greatly ease the panic the earlier draft caused among foreign investors and will help it be passed in late 2019 or early 2020.

Changes relating to the **daily operation of foreign-invested enterprises** include:

- On February 28, 2018, MOFCOM and the State Administration for Industry and Commerce ("SAIC") jointly announced that MOFCOM's record-filing regime for foreign-invested enterprises that are not subject to examination and approval (i.e., those not on the above Negative List introduced in October 2016) would be included in the procedures of the registration authority by using a unified application form. As a result, no separate online record filing with the MOFCOM would be necessary.

- On March 17, 2018, the NPC approved the State Council Institutional Reform Plan of 2018. The State Council now has 26 ministries and departments. The SAIC merged the China Food and Drug Administration, the General Administration of Quality, Supervision, Inspection and Quarantine, the anti-monopoly departments of NDRC and MOFCOM, becoming the State Administration of Market Regulatory ("SAMR"); National Medical Products Administration under SAMR, unified anti-monopoly department under SAMR and China National Intellectual Property Administration under SAMR. In addition, the Legislative Affairs Office of the State Council merged into the Ministry of Justice; China Banking Regulatory Commission and China Insurance Regulatory Commission merged into China Banking and Insurance Regulatory Commission; and the state and local tax authorities at provincial level or below reorganized into unified tax authorities.

- On August 15, 2018, the China Securities Regulatory Commission issued the Revised Administrative Measures for the Equity Incentives of Listed Companies. The application scope for foreign employees is no longer limited to those working in Mainland China, and foreign employees receiving incentives are no longer limited to holding or selling the equity.

- On October 26, 2018, the Standing Committee of the NPC passed the Amendments to the PRC Company Law on Buyback of Shares, which extends the circumstances for companies to buy back their own shares in the case of employee stock ownership plans

and protection of their equity and their shareholder's rights and interests. It also streamlines the procedures for buyback, and establishes a new shareholding method for buyback. The listed companies are now encouraged to buy back their shares more often.

Issues relating to **foreign individuals** include:

- On March 20, 2018, the bilateral agreement on social security between Spain and China, which the delegates of both countries signed on May 19, 2017, officially came into effect. This agreement partially avoids double social security contributions by individuals who work for an employer in one country and are sent to the other to provide services for that employer. It generally applies to pension and unemployment insurance contributions, and will last for 72 months. Spanish employees working in China and contributing to the Chinese social security system will be exempt from 8.5% of the contribution base for individuals and 20.5% for their employers, following Shanghai's example.

- On July 28, 2018, the State Council abolished the work permit for Hong Kong, Macau and Taiwan residents working in Mainland China. The Ministry of Human Resources and Social Security ("MOHRSS") removed the administrative approval procedure. Work permits already issued ceased to be valid on January 1, 2019. Starting on September 1, 2018, Hong Kong, Macau and Taiwan residents that have lived, worked or studied in Mainland China for more than six months can voluntarily apply for residence cards valid for five years. This enables them to benefit from labor rights, participate in social security and housing fund regimes, use compulsory education and basic medical services, take domestic flights and trains, stay in hotels, carry out formalities for bank, insurance, securities and futures trading, register vehicles and apply for driving licenses, and take professional examinations and apply for related qualifications. In addition, MOHRSS released the draft for public comments of the interim measures for the above residents to join the social insurance regime in Mainland China to avoid double payment.

Changes relating to **dispute resolution** include:

- On June 27, 2018, the Supreme People's Court ("SPC") published the Provisions on the Creation of International Commercial Courts. Afterwards, on June 29, 2018, SPC established International Commercial Court No. 1 in Shenzhen and International Commercial Court No. 2 in Xi'an as its standing branches. These two courts hear international commercial cases in first instance, provided the parties agree to SPC's jurisdiction and the amount is higher than CNY 300 million, applications for interim measures before or during arbitration proceedings, and annulment or enforcement of international commercial arbitral awards, provided SPC recognizes these institutions. However, it is still unclear whether foreign arbitrations by international arbitration

institutions can benefit from these new provisions and which parties can apply for interim measures.

- On July 18, 2018, SPC issued the Judicial Interpretations on the application of the statute of limitation stipulated in the General Rules of the PRC Civil Law, effective on July 23, 2018. They clarify how the three-year civil limitation applies to actions and stipulate the suspension of the statute of limitation.

Specific industries welcome new challenges:

- On December 10, 2018, NDRC issued the Administrative Provisions on Investment in the Automobile Industry, effective January 10, 2019. Although not expressly stipulated, they are expected to replace the Policy on Development of Automotive Industry of 2004, the Administrative Provisions on Newly Established Pure Electric Passenger Vehicle Enterprises of 2015, and the Opinions on Improving the Management of Automobile Investment Projects of 2017, which, the NDRC orally confirmed, will be amended or abolished. These investment provisions aim to develop pure electric vehicles, plug-in hybrid electric vehicles and fuel cell vehicles, and provide more detailed and stricter requirements to make new investment and expansion projects of fuel and pure electric vehicles fight overcapacity. Despite of such purpose, all investment projects will only need to file records with the provincial reform and development commission (whole vehicle projects) or the local commission (other projects).

- Another major change to the automobile industry is that the Ministry of Industry and Information Technology ("MIIT") finally issued the Administrative Measures for Market Access Permission for Road Motor Vehicle Manufacturers and Products, effective June 1, 2019, ending the long period of having this administrative approval in place without solid regulations. The measures will encourage qualified manufacturing enterprises to cooperate on R&D and production capacity to allow entrust manufacturing, and encourage vehicle R&D and design enterprises to cooperate with qualified manufacturing enterprises by using the production capacity of the latter to apply for qualification for themselves and their products. This new provision is interpreted as legitimating the current scenario of entrust manufacturing by vehicle R&D and design enterprises.

- The National Medical Products Administration ("NMPA," formerly China Food and Drug Administration, "CFDA") issued the Notice on Implementing the Management of Record-Filing of Imported Non-Special Purpose Cosmetic Products Nationwide on November 7, 2018. Starting from November 10, 2018, NMPA is no longer accepting new applications for approval of imported non-special purpose cosmetic products. Foreign manufacturers of those products are required to appoint and authorize a Chinese entity responsible for record filing of relevant products, and importation and operation of these products, including the whole process after importation, product quality and safety liability. These

practices were first introduced in Pudong New Area, Shanghai, on March 1, 2017, and then in all PFTZs on March 8, 2018. The procedural burden is drastically reduced from more than three months to approximately five business days. The simultaneous launch of new products in China with the world is legally possible, while the *ex post* supervision and fully responsible Chinese entity can still guarantee the product quality and safety.

- On August 31, 2018, the NPC's Standing Committee enacted China's first e-commerce law, which took effect on January 1, 2019, after its fourth reading in five years. This new law applies to all businesses that sell goods or provide services online, which are divided into three types of e-commerce operators: e-commerce platform operators, operators on e-commerce platforms and other e-commerce operators. All e-commerce operators must register with the registration authority, fulfill tax obligations, obtain required approval, license or permit and display it, and show neutral search results. The e-commerce platform operators must record or keep platform transaction information, and cannot delete consumer comments. They also must offer multiple ways to display search results, prominently display the platform service agreement and transaction rules, establish intellectual property rights protection rules, and promptly react against infringement. The administrative penalty imposed for breach will be up to RMB 2,000,000.

Finally, according to the MOFCOM's official statistics, outbound investment by domestic Chinese enterprises reached USD 100 billion by the end of November 2018, slightly increased by 2.5% compared to the same period in 2017. We assume irrational growth has been effectively controlled.

Tax regulations: 2018 update

In 2018, China approved the most significant changes to the Individual Income Tax ("**IIT**") Law in its 38-year history. The reform's main goals were to simplify the IIT system and promote tax fairness. These objectives were met by approving amendments to the IIT Law together with its implementing rules and several supporting regulations.

In parallel, China focused on being more aligned with international standards and practices by increasing the opportunities for nonresident companies to benefit from double taxation treaties ("**DTTs**") by (i) defining the identity of the "beneficial owner" in clauses relating to dividends, interest and royalties; and (ii) interpreting when service providers create a permanent establishment ("**PE**") in China.

This update highlights the most significant tax updates in 2018. Please see our monthly legal flash for more information.

In 2018, China carried out a far-reaching **IIT reform** thanks to the close interaction between the government and the taxpayers (public comments on the draft reform played a key role in the IIT reform process). The regulations issued are outlined below:

- On August 31, 2018, the Standing Committee of the NPC approved the Amendment to IIT Law (the "Amendment"), effective January 1, 2019.

- On September 7, 2018, the Ministry of Finance ("MOF") and the State Administration of Taxation ("SAT") jointly released Caishui [2018] No. 98 on applying the new tax rate table and the new statutory deduction provided under the Amendment in the fourth quarter of 2018.

- On December 13, 2018, the State Council released the Provisional Measures on Special Additional Deductions for IIT, followed by the SAT's release of the Working Measures on Special Additional Deductions for IIT (Trial) on December 21, 2018.

- On December 18, 2018, the State Council published the Implementing Rules on the IIT Law.

- On December 21, 2018, the SAT released the Regulations on IIT Withholding Declaration Method (Trial) and the Announcement on IIT Self-declaration matters.

- On December 27, 2018, the MOF and the SAT jointly released Cai Shui [2018] No. 164 to clarify the continued application of several important preferential tax policies after implementing the Amendment.

Among others, the IIT reform introduced the following major changes:

- It changed the definition on tax residency for non-China-domiciled individuals from the previous full-year rule to the 183-day rule, which is in consistence with international standard.

- It extended the five-year tax exemption policy applied to foreign-sourced income paid overseas to non-domiciled tax residents living in China to six years, while abolishing the accumulative absences of over 90 days outside China to break the period to its completion in order to apply the exemption. Therefore, for this purpose, the non-China-domiciled individuals can break the six-year period by staying outside China for over 30 consecutive days in a tax year.

As a clear signal to retain foreign nationals working in China, non-domiciled tax residents can claim the aforementioned exemption by going through a filing procedure with the tax authorities.

- It introduced a new concept of comprehensive income that includes: (1) wages and salaries; (2) service incomes; (3) incomes from author's remuneration; and (4) royalties, and business operation incomes, while abolished other incomes. As a result, it simplified the tax system by reducing the types of income from eleven to six.

- It raised the statutory deduction for wages and salaries from RMB 3,500 per months to RMB 5,000 per month (i.e., RMB 60,000) per year.

- It introduced special additional deductions to be subtracted from comprehensive incomes, including child education expenses, continuing education expenses, medical expense for serious illness, interest expenses for mortgages, housing rental and supporting expenses for the elderly.

  The expatriates are allowed to choose to apply the special additional deductions granted under the IIT reform or the exemption on selected items granted under the previous rules in 3-year transition period from 2019 to 2021. Afterwards, all expatriates must apply the special additional deductions.

- It made systematic adjustments to tax rate tables that apply to comprehensive incomes and business operation incomes by expanding the brackets, achieving a general tax reduction for taxpayers.

- It also introduced anti-tax avoidance rules for related party transactions, controlled foreign companies and general anti-tax avoidance. However, due to the lacking of the detailed implementation measures, these rules may not be extensive applied in practice in the coming years.

Finally, it maintains the application of the annual bonus special treatment in a three year transition period from 2019 to 2021; from 2022, the annual bonus must be combined with the current year's comprehensive incomes to calculate IIT.

Regarding **international taxation**, the same as in previous years, it is worth mentioning China's effort to reflect its involvement in the Base Erosion and Profit Shifting Action Plan in domestic regulations. To improve the certainty of non-residents benefitting from DTTs, while more efficiently preventing DTT-abusive arrangements, on February 3, 2018, SAT released Announcement [2018] No. 9 ("Circular 9") to upgrade the rules on defining the "beneficiary owner" identity in DTTs.

Circular 9 amended the criteria for assessing the identity of "beneficiary owner" and

expanded the scope of safe harbor rules applied to dividends with descriptive examples. Circular 9 replaced Guo Shui Han [2009] No. 601 and Announcement [2012] No. 30.

In addition, SAT released Announcement [2018] No. 11 to clarify that the "six-month" rule provided in certain DTTs for determining a service PE should be interpreted as "183-days". This interpretation provides the legal ground to support the tax authorities' practice on this matter and avoids confusion and controversy in the future application of DTT treatment.

Other developments in the **international framework** included (i) the signing of a new DTT with Spain on November 28, 2018, which reduces the tax rate on dividends to 5%, when the beneficiary owner is a company directly holding at least 25% equity of the company distributing the dividends for a period of 365 days including the distribution date; and (ii) the conclusion of new DTTs with Gabon, the Republic of Congo, Angola and Argentina.

In the context of **Enterprise Income Tax ("EIT")**, to further encourage foreign investment in China, on September 29, 2018 , the MOF and the SAT jointly released Cai Shui [2018] No. 102 to extend the scope for applying the deferral policy on withholding EIT on profit distributed to overseas investors for direct investment from the previous encouraged projects to all non-prohibited projects.

In addition, China continued to **encourage research and development ("R&D") investment and technological innovation** by releasing the following regulations:

- In January 2018, the SAT released the Implementing Guidance on R&D Expense Super-Deduction Policies (Version 1.0), which is divided into five chapters: (i) an overview of the R&D expense super-deduction policies; (ii) the content of the existing R&D expense super-deduction policies; (iii) the accounting requirements for super-deduction of R&D expenses; (iv) the tax administration on super-deduction of R&D expenses; and (v) the policies on R&D expense super-deduction for small-and-medium technology enterprises. As a whole, the Guidance provides a working manual for the implementation of the R&D expense super-deduction.

- In July 2018, the MOF and the SAT jointly released Cai Shui [2018] No. 76, extending the tax loss carry-forward period up to 10 years for companies with China's High-and-New Technology Enterprise certification and the Small-to-Medium Size Technology Enterprise certification.

- In September 2018, the MOF, the SAT and the Ministry of Technology jointly released Cai Shui [2018] No. 99, increasing the super-deduction ratio for R&D expenses from 50% to 75% for all companies from January 1, 2018, to December 31, 2020.

In March 2018, the State Council announced several major adjustments on value added tax

(“VAT”) policies, effective May 1, 2018, including:

- Reducing the VAT rates from 17% to 16%, and from 11% to 10%, leaving three-tier tax rates: 16%, 10% and 6%;
- Unifying the threshold for VAT general taxpayer status by increasing the threshold for manufacturing companies from RMB 500,000 and commercial companies from RMB 800,000 to RMB 5 million;

- Allowing qualified and advanced manufacturing companies to claim a one-time refund of non-deducted input VAT within a certain period.

This year, the government’s work report also mentioned that VAT would be reduced to two-tier rates; therefore, this new adjustment is an interim measure moving in that direction.

Regarding taxation on **corporate restructuring taxation**, the SAT released Cai Shui [2018] No. 17 on March 2, 2018, and Cai Shui [2018] No. 57 on May 16, 2018, to renew the deed tax and land value added tax exemption policy, effective from January 1, 2018, to December 31, 2020.

Finally, to lessen the tax burden of importers, in May 2018, the State Council Customs Tariff Commission released Shui Wei Hui Gong Gao [2018] No. 3 on reduced tariffs on import of automobiles and spare parts and Shui Wei Hui Gong Gao [2018] No. 4 on reduced tariffs on import of daily use consumer products, effective July 1, 2018. Hence, the tariffs on automobiles (including 139 HS codes) from the most favored countries are reduced to 15%, and the tariff on spare parts (including 79 HS codes) are reduced to 6%.

CUATRECASAS

Contact

Omar Puertas

Partner
omar.puertas@cuatrecasas.com

Cuatrecasas Shanghai office

20 F Shui On Plaza,
333 Huai Hai Middle Road
Shanghai 200021, PRC
+86 21 2327 7000
+86 21 2327 7007
shanghai@cuatrecasas.com

Pablo Cubel

Partner
pablo.cubel@cuatrecasas.com

Cuatrecasas Beijing office

15/F Parkview Green, Tower B,
9 Dong Da Qiao Road
Beijing 10002, PRC
+86 10 5651 0200
+86 10 5651 0268
beijing@cuatrecasas.com

©2019 CUATRECASAS.

All rights reserved.

This document contains legal information produced by Cuatrecasas. This information does not constitute legal advice.

Cuatrecasas owns the intellectual property rights to this document. The information in this document cannot be subject to reproduction in any form, distribution, assignment or any other type of use, in its entirety or in part, without the authorization of Cuatrecasas.