
China offices

Legal flash

2019 – YEAR IN REVIEW



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LEGAL REGULATIONS: 2019 UPDATE

In 2019, China's new legal regime for foreign investment officially took shape. In recent years, the promulgation of China's Foreign Investment Law and a series of complementary laws were the most significant legislative changes on foreign investment, aimed at creating a more equal environment for foreign investors. Moreover, Chinese lawmakers have also published several new enactments in different areas that are worth noting.

Below we summarize the main changes in 2019. For more information, see our monthly legal flash editions.

Developments in the new **Foreign Investment Law**

- The reform of legislation on foreign investments started with an updated version of the draft Foreign Investment Law, which the Standing Committee of the National People's Congress ("NPC") published for public comment on December 26, 2018. This new version is significantly shorter than the previous one published on January 19, 2015 (39 articles compared to the previous 170 articles).
- Aimed at further promoting, protecting and managing foreign investments, on March 15, 2019, the Foreign Investment Law was approved with 42 articles during the second session of the 13th NPC, coming into effect on January 1, 2020.
- Highlights of the Foreign Investment Law
 - The forms of foreign investment include greenfield investments, mergers and acquisitions ("M&A"), investments in new projects, and others. However, whether Chinese individuals can qualify as investors to set up foreign-invested enterprises ("FIEs") with foreign investors and whether the current regulations govern M&A transactions is unclear.
 - It establishes a national access management system consisting of national treatments and a negative list. Foreign investment outside the negative list will be treated in the same way as domestic investments.
 - The longstanding "Three Foreign Investment Laws" (i.e., the Law on Wholly Foreign-owned Enterprises, the Law on Sino-foreign Equity Joint Ventures and the Law on Sino-foreign Cooperative Joint Ventures) are simultaneously abolished.



Consequently, the corporate governance structure established under it are annulled, and China's Company Law will be generally applied to all FIEs.

Other promulgations on foreign investment complementing the Foreign Investment Law:

- On June 30, 2019, the National Development and Reform Commission ("NDRC") and the Ministry of Commerce ("MOFCOM") jointly released (i) the Special Administrative Measures for Foreign Investment Access (Negative List) (2019 Edition) (the "2019 National Negative List"); and (ii) the Special Administrative Measures for Foreign Investment Access in Pilot Free Trade Zones (Negative List) (2019 Edition) (the "2019 Free Trade Zone Negative List"). They both became effective on July 30, 2019, marking the first version of the two Negative Lists following the official promulgation of the Foreign Investment Law.

The 2019 Edition is shorter than the 2018 Edition, reflecting the country's move towards further opening the market to foreign investors.

- On December 26, 2019, the Supreme People's Court released its interpretation of several issues concerning the application of the Foreign Investment Law, effective January 1, 2020. This interpretation aimed to clarify that the validity and effectiveness of investment contracts will not be subject to MOFCOM's approval.
- On December 26, 2019, the State Council formally issued the Implementing Regulations for the Foreign Investment Law (the "Implementing Regulations"), effective January 1, 2020. They expressly state that the Foreign Investment Law and the Implementing Regulations will prevail over the conflicting regulations on foreign investments made before the effective date.

To adapt to the organizational forms and governance structure under the Company Law, the Implementing Regulations set out a five-year transition period for FIEs, which must file the changes with the company registration authorities by January 1, 2025.

Companies that fail to do so will be barred from registering any other changes with the company registration authorities, and the situation will be disclosed to the public.

Regulatory changes relating to the **daily operation of FIEs**

- On February 2, 2019, the People's Bank of China ("PBOC") issued the Decree of PBOC [2019] No. 1, under which enterprises no longer needed approval for bank accounts by



the end of 2019. A record-filing procedure will replace the current bank account opening certificate, making it a quicker process for all enterprises.

- On October 23, 2019, the State Administration of Foreign Exchange (“SAFE”) published a notice on further promoting crossborder trade and investment facilitation (Hui Fa [2019] No.28, the “Notice”). The detailed handling guide for banks was also updated and issued on the same date (the “Guide”).

Highlights of the Notice and the Guide

- Non-investment FIEs can use capital funds to make domestic equity investments.
- The settlement and use of foreign exchange in the security deposit account and asset realization accounts have been liberalized.
- Banks are empowered to handle the cancellation of foreign debt registration.
- One-off foreign debt registration will replace case-by-case registration for non-financial enterprises in the pilot areas such as Guangdong-Hong Kong-Macao Greater Bay Area and Hainan province.

Developments in the **Anti-unfair Competition Law**

- On April 23, 2019, the Standing Committee of the 13th NPC passed a resolution to revise the Anti-unfair Competition Law (the “Revision”), effective on the same date.

The Revision expands the definition of trade secret to include any commercial information (no longer limited to technical and operational information) that is unknown to the public and has commercial value, and for which the obligee has adopted measures to make sure it remains confidential. It also expands the circumstances that constitute infringement of trade secrets. Along with business operators, individuals, legal persons and unincorporated organizations will be liable for infringing trade secrets.

- On June 26, 2019, the State Administration for Market Regulation (“SAMR”) published (i) the Interim Provisions on Prohibiting Monopolistic Agreements (Decree of SAMR [2019] No. 10); (ii) the Interim Provisions on Prohibiting the Act of Abusing a Dominant Market Position (Decree of SAMR [2019] No. 11); and (iii) the Interim Provisions on Preventing the Act of Abusing Administrative Power to Eliminate or Restrict Competition (Decree of



SAMR [2019] No. 12). They all became effective on September 1, 2019 (collectively, the “Three New Anti-Monopoly Regulations”).

The Three New Anti-Monopoly Regulations are the combination of substantive and procedural rules. They aim to (i) provide comprehensive and unified rules for the anti-monopoly law enforcement agencies, and (ii) make the law enforcement environment more transparent and predictable.

The Three New Anti-Monopoly Regulations have reorganized the administrative regulations issued by the NDRC and the former Administration of Industry and Commerce (two of the anti-monopoly law enforcement authorities before the institutional reform of the State Council in 2018), covering three of the four types of monopolistic conducts provided under the Anti-Monopoly Law. The Three New Anti-Monopoly Regulations also establish the rules of jurisdiction, granting general authorization to the SAMR’s provincial counterparts.

Lawmakers start deliberating China’s **Civil Code**

- On December 28, 2019, the draft Civil Code was deliberated at the 15th session of the Standing Committee of the 13th NPC and published for public comment. It is scheduled to be submitted to the third session of the NPC in 2020 for deliberation. If passed, a unified Civil Code will replace the current General Provisions of the Civil Law, the General Principles of the Civil Law, the Marriage Law, the Law of Succession, the Adoption Law, the Security Law, the Contract Law, the Real Right Law, and the Tort Law.

Updates on **dispute resolution**

- On January 18, 2019, the Supreme People’s Court and the Hong Kong Government signed the Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Cases by the Courts of Mainland China and of Hong Kong (the “Arrangement”). The Arrangement clarifies the scope of legally binding judgments in Mainland China, covering both monetary and non-monetary judgments. It allows the court to impose property preservation and compulsory measures under the law of the place where the court is located before or after accepting an application under the Arrangement.
- On April 2, 2019, the Department of Justice of Hong Kong and the Supreme People’s Court of Mainland China signed the Arrangement on Mutual Assistance in Court-ordered Interim Measures in Aid of Arbitral Proceedings by the courts of the two territories. It



became effective on October 1, 2019, and it allows parties to “arbitral proceedings” in Hong Kong to apply to the competent People’s Court in Mainland China for interim measures, including property preservation, evidence preservation and conduct preservation.

- On October 19, 2019, the Shanghai Municipal Bureau of Justice published the Administrative Measures for Business Offices Established by Overseas Arbitration Institutions in Lin-gang Special Area of China (Shanghai) Pilot Free Trade Zone (“Administrative Measures”), effective January 1, 2020.

As the specific rules on operation of foreign arbitration institutions in the Lin-gang Free Trade Zone (“Lin-gang FTZ”) following the publication of the “Overall Plan for Lin-gang Special Area of China (Shanghai) Pilot Free Trade Zone,” launched on August 6, 2019, the Administrative Measures set out establishment requirements, application and registration procedures, scope of business, management, and legal liability of business offices.

One remarkable point under the Administrative Measures is that foreign arbitration institutions established in Lin-gang FTZ can administer foreign-related arbitrations in the Lin-gang FTZ. Before this, the representative offices that foreign arbitration institutions set up in Mainland China could not do so.

However, the Administrative Measures remain unclear in many issues, e.g., whether arbitrations that foreign institutions administer in the Lin-gang FTZ will be considered arbitration seated in China, or whether the awards made under the Administrative Measures will be considered “foreign awards” under the New York Convention or foreign-related awards like those made by Chinese institutions.

Updates on **intellectual property rights**

- On January 4, 2019, the Standing Committee of the NPC published the Draft Amendments to the Patent Law for public comment, introducing the following main changes:
 - Extending the design patent term from 10 to 15 years from the date the patent application is submitted.



- Allowing design patents to have priority over any application on the same subject filed with China's National Intellectual Property Administration ("CNIPA") within six months following their application in China.
 - Introducing the open license regime, which enables patentees to grant an open license under certain payment terms and standards for royalty by submitting a written statement to the CNIPA.
 - Placing the burden of proof on the alleged infringer to provide accounting books and data.
 - Increasing the economic liability for patent infringement.
- On April 23, 2019, the Trademark Law was revised at the 10th session of the Standing Committee of the 13th NPC, effective November 1, 2019, introducing the following main changes:
- Providing the rejection of malicious application for trademark registration that is not filed with the intent to use.
 - Adding malicious application for trademark application as a legitimate reason to object to or invalidate a trademark.
 - Including punishments for the person who files a malicious application and for the non-complying trademark agent.
 - Increasing punitive damages and court-determined monetary compensation for trademark infringement.
 - Empowering the court to order the destruction of the goods bearing counterfeit registered trademarks and the materials and tools used to manufacture them if requested (except under special circumstances) or to prohibit those materials and tools from entering any commercial channel.

New efforts in the field of **cybersecurity**

- On May 13, 2019, the SAMR and the National Standardization Administration Commission jointly issued three national standards for implementing the cybersecurity classified protection system, which became effective on December 1, 2019.



- On May 24, 2019, the Cyberspace Administration of China (the “CAC”) released the draft Measures on Cybersecurity Review for public comment, subjecting the procurement of network products and services by critical information infrastructure operators that may affect national security to cybersecurity review.
- On May 28, 2019, the CAC released the draft Administrative Measures on Data Security for public comment, setting out obligations for network operators carrying out data activities, particularly those that involve collecting personal information and important data.
- On November 28, 2019, four government departments jointly issued the Methods for Identifying Apps’ Unlawful Collection and Use of Personal Information (Guo Xin Ban Mi Zi [2019] No. 191), effective on the same date, aiming to provide more specific references for law enforcement authorities to identify apps’ violations when collecting and using personal information and for app operators to conduct self-checks and self-corrections.

New challenges for certain industries

Automotive industry

On December 10, 2018, the NDRC issued the Administrative Provisions on Investment in the Automobile Industry (Decree of the NDRC [2018] No. 22, the “Investment Provisions”), effective January 10, 2019. To offset overcapacity in the automobile industry, the Investment Provisions stipulate detailed, stricter requirements that must be fulfilled for new investment and expansion projects. However, the record-filing regime that the Investment Provisions introduce will simplify the application procedure.

Pharmaceutical industry

On August 26, 2019, the 12th session of the Standing Committee of the 13th NPC approved the revision of the Drug Administration Law, effective December 1, 2019. This is the first comprehensive overhaul since the 2001 revision.

One of the most significant changes the revised Drug Administration Law brings to the pharmaceutical industry is the establishment of the Marketing Authorization Holder (“MAH”) system. This system enables research and development institutions and individual researchers located in the pilot areas to participate further in bringing products to market by allowing them to apply for drug registrations and become MAHs. The role of MAH is to ensure drug safety, effectiveness and quality at all lifecycle stages. MAHs without production



capacity must outsource the manufacturing of products to licensed, GMP-certified drug manufacturers.

TAX REGULATIONS: 2019 UPDATE

To improve the business environment and deepen tax reform in China, 2019 saw four overriding themes in the area of tax development: (i) granting large-scale tax benefits to reduce taxpayers' burden; (ii) enhancing international collaboration in tax collection under the "One Belt and One Road" initiative; (iii) accelerating tax legislation progress; and (iv) further streamlining the tax administration procedures.

This update highlights the most significant tax developments in 2019.

In 2019, the biggest tax event in China was **the large-scale tax benefits granted to taxpayers, especially for value-added tax ("VAT")**. On March 20, 2019, the Ministry of Finance ("MOF"), the State Administration of Taxation ("SAT") and the General Administration of Customs ("GAC") jointly released the tax circular Announcement [2019] No. 39 ("Circular 39"), which grants a series of VAT benefits, effective April 1, 2019.

Main benefits outlined in Circular 39

- From April 1, 2019, VAT rates were further reduced from (i) 16% to 13% for selling and importing goods and leasing movable assets; and (ii) from 10% to 9% for providing transport, postal, basic telecommunications and construction services, real estate leasing and selling and transferring land use rights.
- From April 1, 2019, taxpayers can claim a refund of non-deducted input VAT credits (i.e., introducing a VAT refund mechanism for domestic transactions), provided they:
 - have VAT credits above zero for six consecutive months (or for two consecutive quarters, if they declare VAT on a quarterly basis), and the incremental VAT credits in the sixth month is at least RMB 500,000;
 - have an A or B tax credit rating;
 - they did not incur VAT fraud in the 36 months before the application;



- they were not penalized twice or more times for tax evasion in the 36 months before the application; and
- they have not benefitted from other VAT collection and refund policies since April 1, 2019.

Also, under the tax circular Announcement of MOF and SAT [2019] No. 84 concerning the VAT refund policy for certain advanced manufacturing industries, released on August 31, 2019, taxpayers in certain advanced manufacturing industries (i.e., non-metallic mineral products, general equipment, special equipment, computers, communication devices, and other electronic equipment) can benefit from the VAT refund policy without reaching the RMB 500,000 threshold from June 1, 2019.

- From April 1, 2019, to December 31, 2021, taxpayers in manufacturing and consumer service industries can deduct an additional 10% of input VAT (i.e., introducing a VAT super-deduction mechanism).

The scope of manufacturing and consumer service industries includes (i) postal service; (ii) telecommunication service; (iii) modern service; and (iv) consumer service, as defined under tax circular Caishui [2016] No. 36.¹

Also, under tax circular Caishui [2019] No. 87 concerning the VAT super-deduction policy for consumer service industries, released on September 30, 2019, this additional deduction ratio was increased to 15% for consumer service industries, effective from October 1, 2019.

- From April 1, 2019, taxpayers purchasing real estate or construction in progress can apply a one-time deduction of input VAT from the purchase (which was previously spread over two years).
- From April 1, 2019, the input VAT from taxpayers purchasing domestic passenger transport services is deductible.

¹ The tax circular on the full expansion of VAT reform (Caishui [2016] No. 36) was released on March 23, 2016, and it became effective on May 1, 2016.



Also, to reduce the tax burden of small enterprises, from January 1, 2019, to December 31, 2021, small-scale VAT taxpayers with a monthly revenue of up to RMB 100,000 can benefit from VAT exemption.²

From February 1, 2019, to December 31, 2020, free lending of funds among entities within the same group is exempt from VAT.³

This large-scale tax-cutting campaign is also reflected in the **enterprise income tax (“EIT”)**, mainly relating to fixed asset depreciation and small and low-profit enterprises.

Main tax benefits

- From January 1, 2019, all manufacturing companies can shorten the tax depreciation period or adopt tax accelerated depreciation methods (i.e., double declining balance method or the sum of the year’s digits method) for newly purchased fixed assets.⁴
- Circular 13 relaxes the criteria for small and low-profit enterprises that are entitled to apply a reduced EIT rate of 20%:
 - Annual taxable income up to RMB 3 million
 - Number of employees up to 300
 - Total assets up to RMB 50 million
- From January 1, 2019 to December 31, 2021, for small and low-profit enterprises:
 - The part of annual taxable income up to RMB 1 million is included in the taxable income at 25% (i.e., effective EIT rate of 5%).
 - The part of taxable income from RMB 1 million to RMB 3 million is included at 50% (i.e., effective EIT rate of 10%).

The first year the new **Individual Income Tax (“IIT”) Law** in China was fully implemented was 2019. To shed light on several key tax issues, particularly taxation on expatriates working in

²The tax circular on the implementation of tax reduction and exemption policies for small and low-profit enterprises (Caishui [2019] No. 13) was released on January 17, 2019, retroactive to January 1, 2019 (“Circular 13”).

³The tax circular on several VAT exempt policies (Caishui [2019] No. 20) was released on February 2, 2019, and it became effective on the same date.

⁴The tax circular concerning expanding the accelerated depreciation preferential policy on fixed assets (Announcement of MOF and SAT [2019] No. 66) was released on April 23, 2019, retroactive to January 1, 2019.



China and individual partners of venture capital enterprises, the following regulations were released:

- The tax circular Announcement of MOF and SAT [2019] No. 34⁵ provides criteria for determining the period of residence in China for non-domiciled individuals. It also clarifies that the “six-year rule” to exempt foreign-sourced and foreign-paid income applicable to non-domiciled individuals will be counted from 2019 (i.e., the residence record before 2019 will be erased).
- The tax circular Announcement of MOF and SAT [2019] No. 35⁶ clarifies IIT calculation methods for nonresident individuals and non-domiciled resident individuals. It changes the IIT calculation mechanism on salary incomes from the previous “calculate tax on global income first, and then split tax between taxable and non-taxable incomes” to “split global income first between taxable and non-taxable incomes, and then calculate tax on taxable income,” which is considered a more sensible approach.
- The tax circular Caishui [2019] No. 8⁷ provides two IIT methods for individual partners of venture capital enterprises to choose relating to the incomes arising from capital gains of equity transfer and dividends:
 - If the venture capital enterprise chooses to conduct accounting based on each single investment fund, the income arising from the capital gains of equity transfer and dividends from the funds for the individual partners is subject to 20% IIT.
 - If the venture capital enterprise chooses to conduct accounting as a whole and on a yearly basis, the income arising from the venture capital for the individual partners is subject to IIT as “operational income” at progressive rates between 5% and 35%.
- The tax circular Caishui [2019] No. 31⁸ provides IIT exemption for the subsidies granted to the top and urgently needed foreign talents (including Hong Kong, Macao and Taiwan) working in the Guangdong-Hong Kong-Macao Greater Bay Area. The subsidies are based

⁵ The tax circular concerning the criteria for determining the period of residence in China for non-domiciled individuals (Announcement of MOF and SAT [2019] No. 34) was released on March 14, 2019, retroactive to January 1, 2019.

⁶ The tax circular concerning IIT policies for non-resident individuals and non-domiciled resident individuals, (Announcement of MOF and SAT [2019] No.35) was released on March 14, 2019, retroactive to January 1, 2019.

⁷ The tax circular concerning IIT policy for individual partners of venture capital enterprises (Caishui [2019] No. 8) was released on January 10, 2019, retroactive to January 1, 2019.

⁸ The tax circular concerning the IIT preferential policy for the Guangdong-Hong Kong-Macao Greater Bay Area (Caishui [2019] No. 31) was released on March 14, 2019, retroactive to January 1, 2019.



on the difference in the IIT burden between the mainland and Hong Kong.

Government authorities are also committed to strengthening the IIT credit building system and establishing a sharing IIT tax credit record database. Discredited individuals will be placed on the tax authorities' watch list, imposing administrative restrictions and penalties by law. In serious cases, the discredited individuals will be disclosed to the general public, and this information will be shared in the national credit platform.

In the context of **international taxation** in 2019, with the continuing development of the "One Belt One Road" initiative, China has been working on the collaboration mechanism for tax collection and administration with other countries. On April 18, 2019, China and 34 other countries jointly signed a memorandum, signaling the establishment of the "One Belt One Road" Tax Collection and Administration Collaboration Mechanism.

Other developments in the **international framework** include (i) the signing of a new double taxation treaty ("DTT") with Italy on March 23, 2019; and (ii) the signing of a new DTT with New Zealand on April 1, 2019, which came into effect on December 27, 2019, and is applicable to tax matters and income from January 1, 2020.

Also, to simplify the procedure for applying DTT benefits, from January 1, 2020, nonresident taxpayers only need to file a standard reporting form for declaration purposes. However, they must keep the other relevant documents available for the tax authorities' future review.⁹ This new procedure will make it more convenient for nonresident taxpayers to benefit from DTT treatment. However, it also raises the requirement on nonresident taxpayers' awareness of keeping other relevant documents.

There is another development worth mentioning in the area of **customs administration**. To encourage companies to conduct regular self-assessment, customs mitigates the consequences of violation through voluntary disclosure.¹⁰

Therefore, customs will not impose an administrative penalty if importers voluntarily disclose to customs:

⁹ The Administrative Measures on Nonresident Taxpayers Benefiting from Tax Treaty Treatments (SAT Announcement [2019] No. 35) was released on October 14, 2019, and it became effective on January 1, 2020.

¹⁰ The customs circular concerning treatment for tax-related violations under voluntary disclosure (GAC Announcement [2019] No. 161) was released on October 17, 2019, and it became effective on the same date.



- the tax-related violations **within** three months of their occurrence and take the initiative to eliminate the harmful consequences; or
- the tax-related violations **after** three months following their occurrence, the underpaid taxes account for less than 10% of the payable tax amount, or the underpaid taxes are below RMB 0.5 million, and the importers take the initiative to eliminate the harmful consequences.

Also, if the importers make a voluntary disclosure, and customs imposes a warning or an administrative penalty under RMB 0.5 million, this information will not affect the importers' credit rating with customs.

In the context of **tax legislation progress in China**, in 2019, the following tax laws came into effect:

- Vehicle Purchase Tax Law on July 1, 2019
- Farmland Occupation Tax Law on September 1, 2019

The standing committee of the NPC also approved the following tax law in 2019:

- Resource Tax Law (which will become effective on September 1, 2020)

MOF and SAT also released the drafts of the following tax laws for public comment:

- Land Appreciation Tax Law
- City Maintenance and Construction Tax Law
- Stamp Duty Law
- Consumption Tax Law
- VAT Law

Pending tax laws to be drafted:

- Customs Duty Law
- Urban Land Usage Tax Law
- Real Estate Tax Law
- Deed Tax Law

According to the official legislative schedule, all these tax laws pending to be legislated will be released in 2020.



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