

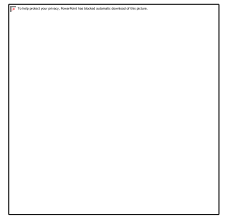
China tax and legal update: what China is doing in response to a trade war and a war on COVID-19

This information does not, and is not intended to, constitute legal advice. All information, content, and materials are for general informational purposes only. No reader should act, or refrain from acting, with respect to any particular legal matter on the basis of this information without first seeking legal advice from counsel in the relevant jurisdiction.

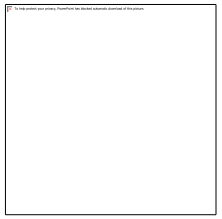
Agenda

I. Issues impacting China
II. Stabilizing foreign investment amid trade war
III. Tax incentives for fighting COVID-19
IV. COVID-19 as a force majeure – defense for legal and tax?
V. Other developments
VI. Post-pandemic prospects

Presenters



Windson Li
Head, Tax Group, China
DLA Piper, Beijing
windson.li@dlapiper.com
T: +86 10 8520 0609



Peng Tao
Foreign Legal Consultant, Tax
DLA Piper, Hong Kong
peng.tao@dlapiper.com
T: +852 2103 0511

I. Issues impacting China



Immediate impacts from COVID-19

- Q1 2020:
  - GDP down by 6.8%; FDI down by 10.8%; tax revenue down by 16.8%
- Q1 exports down by 6.4%
  - April alone saw an increase of ~8.2% (medical supplies and computers)
- March NPC delayed to May 21, 2020
- First online Canton Fair scheduled for June 15-24, 2020
- Reopening business gradually from mid-February
  - Sales revenue is close to 95% of comparable level from 2019, measured by VAT invoices data as of April 30, 2020
- Containing imported cases of the coronavirus disease 2019 (COVID-19)
  - Travel ban for foreign passport holders from March 28, 2020
- Preventing a second wave of virus outbreak
  - Recent cases in Heilongjiang, Jilin and Hubei
  - Announced plans to conduct 11 million tests in Wuhan over 10 days, beginning May 12, 2020

Trade war

- Dialogue with US on trade agreements heated up in early May 2020
  - Mixed messages reported on both sides
  - Whether to honor the first phase trade agreement
  - Whether to start negotiations on the second phase trade agreement
  - Status of implementation of the first phase trade agreement

II. Stabilizing foreign investment amid trade war



Foreign Investment Law and implementing regulations

- Foreign Investment Law
  - Approved by National People's Congress on March 15, 2019, effective from January 1, 2020
  - New foreign investment regulation regime: negative list
  - One foreign investment law replacing three FDI laws on WFOEs and JVs
  - Equal treatment of foreign and domestic enterprises
  - Investment promotion and protection of intellectual property rights, technology transfers, and equal participation in government procurement and standard-setting
- Implementing the Foreign Investment Law
  - Issued by the State Council on December 26, 2019, effective from January 1, 2020
  - Simplified incorporation process
  - Foreign investment information reporting

Encouraging Catalog and Negative Lists

- Industry Catalog for Encouraging Foreign Investment (2019)
  - Issued jointly by the MOFCOM and National Development and Reform Commission (NDRC) on June 30, 2019
  - Sector-based, 415 items (67 items added and 45 items modified), and geography-based (Midwest-China), 693 items (54 items added and 165 items modified), compared with 2017 version
  - Added areas such as 5G, pharmaceuticals, new materials and manufacturing services
- Free Trade Zone (FTZ) Negative List for Foreign Investment (2019)
  - Issued jointly by the MOFCOM and NDRC on June 30, 2019
  - Down to 37 items from 45 items (-17.8%) compared with 2018 version
  - Cancelled restrictions on **aquatic product catching** and **publication printing**
- National Negative List for Foreign Investment (2019)
  - Issued jointly by the MOFCOM and NDRC on June 30, 2019
  - Down to 40 items from 48 items (-20.8%), compared with 2018 version
  - Cancelled certain restrictions on **value-added telecommunication**, **cinema operation**, **performance brokerage**, etc.
- China is considering further narrowing down the current native lists

Tariff exclusion

- Announcement from the Customs Tariff Commission of the State Council on Starting the Work on Tariff Exclusion for Some US Imports under Market-based Purchase ([2020] No. 2)
  - Issued on February 17, 2020
  - Waived certain US products imported by Chinese importers from retaliatory tariffs of China
  - On the list: can apply for tariff waiver
  - Not on the list: can apply for addition to the waive list
  - Parcel imported by express mail: automatically excluded
- Announcement from the Customs Tariff Commission of the State Council on the First Exclusion List of the Second Batch of Commodities Subject to Additional US Tariff ([2020] No. 3)
  - Issued on February 21, 2020, covering imports from Feb 28, 2020 to Feb 27, 2021 (one year)
  - List No. 1: Retaliatory tariff waived + refund if already imposed within six months of the date of publishing of the list
  - List No. 2: Retaliatory tariff waived, but no refund if already imposed
- Announcement of the Customs Tariff Commission of the State Council on the Second Exclusion List of the Second Batch of Commodities Subject to Additional US Tariff ([2020] No. 4)
  - Issued on May 12, 2020, covering imports from May 19, 2020 to May 18, 2021 (one year)
  - Retaliatory tariff waived + refund if already imposed within six months of the date of publishing of the list

Improving business environment

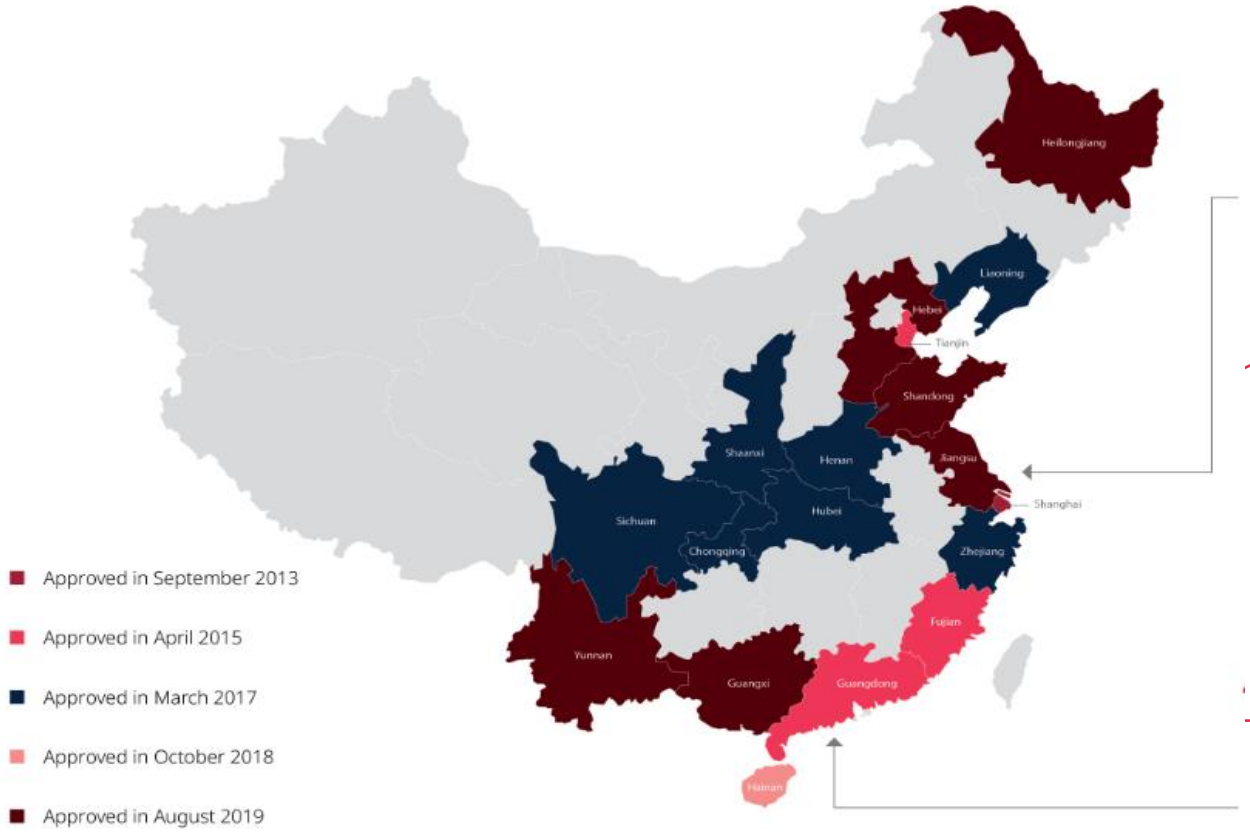
- The State Council released new Regulations on Improving Business Environment on October 22, 2019, effective from January 1, 2020
- A rare regulation that mainly consists of advocacy provisions and no strong enforcement measures
- The World Bank ranks China number 31 among 190 economies in terms of ease of doing business in its newly released *Doing Business 2020*, the 17th edition of its study on doing business around the world

Further opening up – regions

- February 18, 2019, China adopted the Outline of Development Planning for Greater Bay Area
- July 2, 2019, China adopted the Outline of Development Planning for Integrated Yangtze River Delta
- July 27, 2019, China approved the addition of a Lingang New Area to the Shanghai Free Trade Zone
- August 2, 2019, China approved six new Free Trade Zones
- August 9, 2019, China issued Opinions on Supporting Shenzhen in Building a Pioneer Model Zone for Socialism with Chinese Characteristics
- Upcoming: May 21, 2020, additional Free Trade Zones are expected to be designated by NPC

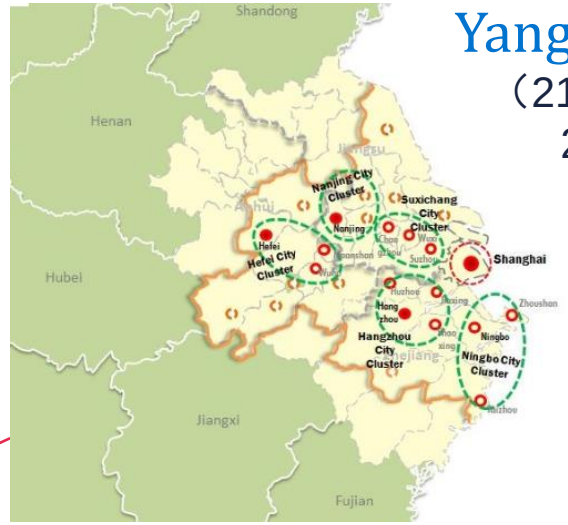
Further opening up – Free Trade Zones

China's 18 pilot Free Trade Zones



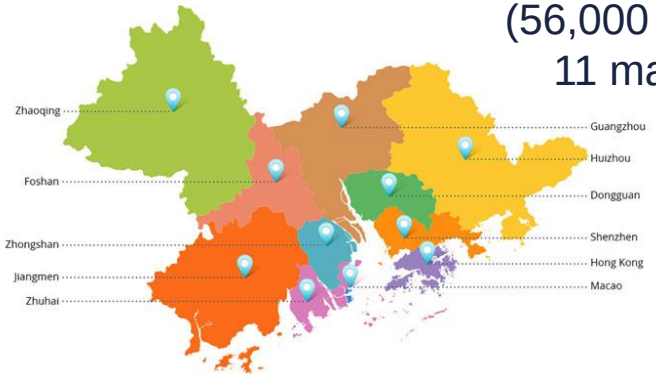
Yangtze River Delta

(211,700 square km)
26 major cities



Greater Bay Area

(56,000 square km)
11 major cities



Greater Bay Area incentives

- To grant subsidies to foreign “high-level talents” (including Hong Kong, Macao and Taiwan) and “urgently-needed talents” working in the Greater Bay Area based on the extra IIT paid in China – such subsidies are exempt from IIT
  - In Guangzhou, subsidy available if the IIT payable is greater than 15%
- Proposed tax incentives
  - To coordinate tax policies for Greater Bay Area and roll out further tax incentives
  - To remove industry restrictions for R&D expense super deduction
  - To enhance qualifying conditions for HNTE and lower the limit for companies enjoying EIT half reduction
  - To promote tax incentives for entrepreneurship
  - To further stimulate procurement of HNTE products by increasing government procurement, formulating HNTE product procurement details and list

Further opening up – financial industry

- Relevant Measures for Further Opening Up Financial Industry (11 measures)
  - Announced by the Office of the Financial Stability and Development Committee under the State Council on July 20, 2019
  - Covering credit rating, wealth management, pension management, currency brokerage, insurance, fund management, futures and inter-bank bond market
  - Next round of revisions to negative lists and other regulations
  - Some highlights:

Sub-sector	Current practice (2019)	11 Measures
Insurance	• Qualified foreign insurer investor must have an operational history of more than 30 years in insurance business • The foreign shareholding in an insurance asset management company is restricted up to 25% • Phaseout of the 51% foreign shareholding cap in a life insurance company will be removed in 2021	• 30-year insurance history requirement is removed • The foreign shareholding restriction in an insurance asset management company can be greater than 25% • Phaseout of the 51% foreign shareholding cap will be removed in 2020.
Securities/ fund management/ futures	• Phaseout of the 51% foreign shareholding cap in securities, fund management and futures companies will be removed in 2021	• Phaseout of the 51% foreign shareholding cap will be removed in 2020
Pension management	• Few domestic financial institutions established the pension fund management company	• Allow foreign financial institutions to invest and participate in establishment of pension management companies

Reduction of VAT rate

- China further reduced its standard VAT rates to help its manufacturers struggling as a result of the US-China trade war
- Two cuts
  - May 1, 2018: 17% → 16%; 11% → 10%
  - April 1, 2019, 16% → 13%; 10%→ 9%
- The tax cut will largely benefit struggling Chinese manufacturers as well as consumers
- Additional tax incentives
  - 10% super input VAT credit eligible to manufacturers and lifestyle-related service providers, to lessen the overall tax burden of taxpayers
  - Refund of qualified input VAT balance carried forward from previous periods, to relieve the cash flow pressure on taxpayers

Withholding tax exemption on dividends for re-investment

- From January 1, 2018, foreign investors' direct reinvestment in China using profits distributed by China resident enterprises qualifies for withholding tax deferral until the foreign investors' disposal of such reinvestment in China
- **Scope**: expanded from investing in encouraged industries to all non-prohibited industries
- **Qualifying conditions**:
  - Includes setup of new companies, acquisition of Chinese domestic companies' shares from unrelated parties, or increase in capital of domestic companies
  - Excludes investment in newly issued or converted shares of listed companies or acquisition of publicly listed companies' shares
- **Tax recordal**: foreign investors to perform tax recordal with tax authorities to qualify for withholding tax deferral
- **Foreign exchange control**: though reinvestment can be made in RMB directly routed from dividend paying entities to newly invested companies, in practice such reinvestment may still be viewed as foreign investment and subject to foreign exchange control

New foreign exchange measures

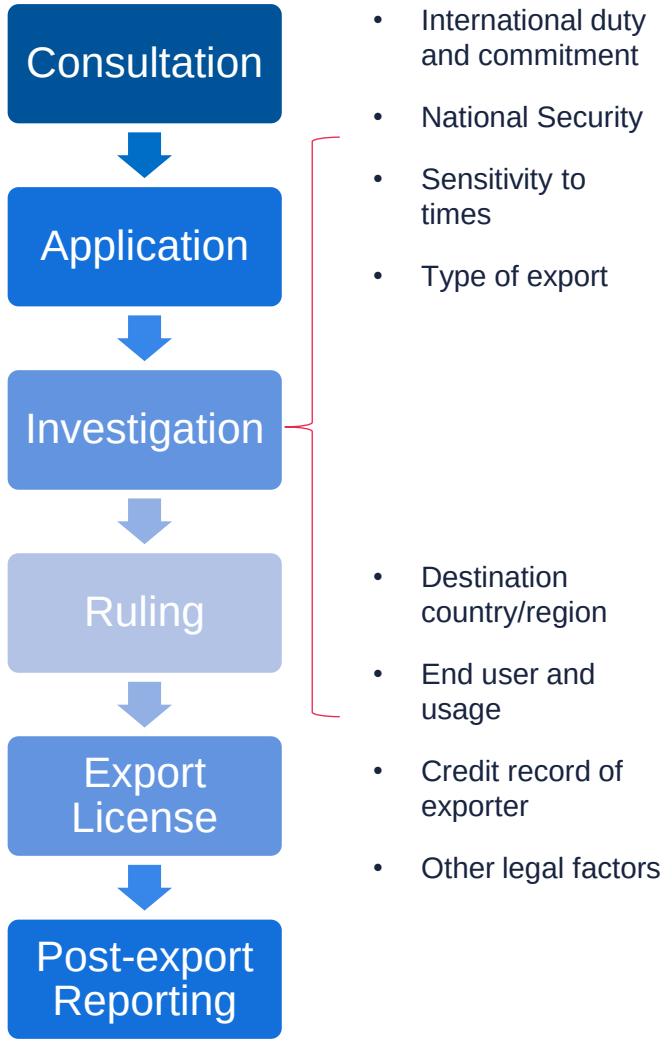
- The State Administration of Foreign Exchange (SAFE) released a Circular on Further Promoting Facilitation of Cross-border Trade and Investment on October 23, 2019, effective the same date
  - Allowing non-investment FIEs to make equity investment by using registered capital, subject to negative lists
  - Allowing qualified enterprises in certain trial areas to make domestic payments by using their capital, foreign debts and offshore listing, without providing materials to banks for verification in each case
  - Allowing non-financial enterprises in trial areas not to make foreign debt registration each time for debts borrowed no more than two times the net asset
- SAFE issued a new Circular on Improving Foreign Exchange Administration for Supporting Development of Foreign Related Business on April 14, 2020, effective the same date
  - Expanding the areas nationwide striking requirement of supporting materials to banks

Measures on Network Security Review

- Effective from June 1, 2020
- Jointly issued by 12 ministries including Cyberspace Administration of China, NDRC, MIIT, Public Security Ministry, National Security Ministry, Ministry of Finance, MOFCOM, PBOC and SMAR
- Critical Information Infrastructure (CII)
- Critical Information Infrastructure (CIIO)
- For safety of supply chain of network products and services
- Contractual requirements on suppliers of CIIO to cooperate
- Typical review vs. special review
- Blacklist vs. whitelist?

China Export Control Law (draft)

- Chinese Ministry of Commerce (MOFCOM) published the first draft of the Export Control Law in June 2016 for public comments
- The Standing Committee of People's Congress released a second draft of the Export Control Law in December 2019 for public comments
  - **Scope**: dual-use items, military items, nuclear items, other items affecting the national security of China
  - **Deemed export**: transfer of ownership outside China may also be subject to the law
  - **Measures**: export control lists/catalogues, export license, operator registration/certification, valuation of end user and usage
  - **Compliance**: follow up reporting duty of exporter; compliance duty of agent, forwarder, courier, customs broker and e-commerce platform
  - **Blacklist:** PRC authorities may place foreign importers and end users violating PRC export control laws on a blacklist – such action would prohibit the export of controlled items to those foreign importers and end users
  - **Retaliatory measures: a**uthorizing corresponding retaliatory measures against the countries or regions that implement discriminatory control measures on the PRC



Technology Security Management List

- China has started the process to set up a National Technological Security Management List system to forestall and defuse risks to national security and to protect the country's key technologies
  - The National Development and Reform Commission is leading the legislation process
  - Establishment of the list system is in line with current international practices
- Focusing on technology exports
- May include criteria on technology imports based on the concept of “Secure and Controllable”



Unreliable Entity List

- To be promulgated in the near future
- The Four Criteria
- An investigation procedure and an appeal process
- Restriction on sales, import/export, investment and operation license, as compatible to the level of danger / damage to China enterprises, industry, national security
- On the listed entity, and likely also on its parent company / affiliates and even the relevant senior management and decision making individuals
- A separate regime or a chapter in Export Control Law?

	China	US
Name	The Unreliable Entity List	The Entity List
Issuing authority	The Ministry of Commerce	The Bureau of Industry and Security
Criteria	(i) with discriminatory measures/ behaviors against Chinese companies, such as boycotting or cutting off supplies (ii) with measures/behaviors taken for non-commercial purposes and against the market rules and contractual obligations (iii) with material damage caused to the Chinese companies and the related industries and/or (iv) with potential threat to China's national security.	Entities, individuals or other organizations which, based on reasonable doubts, may or have a high possibility to engage in activities endanger
Supervising authority	TBD	The End-User Review Committee
Delisting	Appeals process + may be delisted after correcting the violating behaviors	Application process + explanation of the causes and correcting the violating behaviors

Social Credit System

- Guiding Opinions on Accelerating Construction of Social Credit System and Establishment of New Regulatory Regime based on Credit, issued by the General Office of State Council, July 9, 2019
- Applicable to both individual and companies
  - Concept started in 2013, fast development began in 2016 and now a powerful regulatory tool
  - Further evolvements after 5G
- Internet and supervision
  - Joint punishment and joint rewarding
  - Losing credit in one place, restricted everywhere
- Rating
  - Court enforcement
  - Market supervision
  - Tax and customs
  - Environmental protection
  - Banking
  - Vaccine, drug and medical device
  - Product safety …

Social Credit System (cont'd)

- National Credit Information Sharing Platform
  - Monthly update for publication
- Blacklisting – restricted from:
  - Taking trains and airplanes
  - Receiving fiscal subsidy
  - Purchasing real property or state-owned assets
  - Holding senior management roles in companies
  - Participating in government procurement or project bidding
  - Other
- Concerns
  - Lack of national law on social credit
  - Protection of privacy vs. information disclosure and sharing
  - Equity and fairness
  - Remedies

Restoring tax credit

- Public Announcement on Restoring Credit on Tax Payment, issued by the State Administration of Taxation on November 7, 2019, effective from January 1, 2020
- The following three types of taxpayers may apply to restore their tax credit:
  - Taxpayers who failed to declare taxes, pay taxes or submit tax materials before deadline who have rectified the failures
  - Taxpayers classified as D Class because of failure to pay taxes, late payment charges and fines as required by the tax decision who rectified the failure within 60 days from the expiration of the relevant period specified under the tax decision
  - Taxpayers who started fulfilling their legal obligations and their abnormal tax status has been lifted by the tax authority
- Can apply before the end of the next year following the year with an abnormal tax status

III. Tax incentives for fighting COVID-19



Incentives directly relating to fighting COVID-19

- To support prevention and control of COVID-19
  - IIT exemption on certain allowances received from employers
- To support supply of epidemic control materials
  - VAT exemption and refund (manufacturer, transportation, courier, etc.)
  - Expensing capital equipment
- To encourage donation
  - 100% deduction for both individual and enterprise income taxes on qualified donation
  - VAT and surtaxes exemption on donated materials
  - Duty exemption for expanded imported materials

Incentives to support business reopening

- Losses incurred in 2020 can be carried forward for eight years (transportation, catering, hotel and tourism)
- Temporary VAT exemption on small scale VAT taxpayers
- Temporary reduction and exemption on social security contribution
- Tax incentives to landlords who reduced rents

Incentives for promoting export and consumption

- Increase export VAT refund rate for certain exported products
- VAT reduction for dealers of secondhand automobiles
- Renewal of exemption of vehicle purchase tax on new energy cars

Renewing tax incentives for developing Western China

- 15% income tax rate
- Western China
  - Inner Mongolia, Guangxi, Chongqing, Sichuan, Guizhou, Yunnan, Tibet, Shaanxi, Gansu, Qinghai, Ningxia and Xinjiang
  - Four sub-province states in Hunan, Hubei, Jilin and Jiangxi
- Catalog of Encouraged Industries in Western China
  - Threshold: 60% of total revenue arising from business under the catalog
  - To be updated
- January 1, 2021 to December 31, 2030

IV. COVID-19 as a force majeure



Force majeure defense for legal and tax?

- Force majeure defined by PRC contract law and civil law
  - Objective circumstances
  - Unforeseeable, unavoidable and insurmountable
- Contract may be terminated if the purpose of the contract cannot be realized because of the FM event
- Timely notice of FM occurrence
- Proof of FM event as soon as practically possible
- Press release by NPC in February
- FM certification issues by local authorities

Force majeure defense for legal and tax? (cont'd)

- Guiding Opinions (I) on Several Issues Concerning Proper Trial of Civil Cases Related to the COVID-19 Epidemic by Law, issued by the Supreme People's Court on April 12, 2020
  - Force majeure may be applicable due to the epidemic or due to the epidemic prevention and control measures
  - The party who claims for full or partial exemption from obligations due to force majeure shall have the burden of proof
  - Unable to perform vs. difficult to perform
    - Difficulty is not a basis to terminate contracts
    - Court may support changes to contract if the continuous performance of contract is obviously unfair to a party, but not support partial or full exemption from obligation after contracts are changed
  - Court may assess the possibility of continuous performance of contract by taking into account of the governing provided subsidies, tax relief, assistance by other parties, or debt reduction or exemption

Force majeure defense for legal and tax? (cont'd)

- Support for employers to adopt flexible working methods during the epidemic prevention and control period
- Does not support termination of employment contract simply because the employee may be a diagnosed patient, or suspected, asymptomatic infected, or quarantined, or coming from the epidemic areas
- Punitive compensation may be awarded to consumers pursuant to applicable laws in relation to certain drug, food or supply of materials for prevention and control of epidemic
- Suspension of statute of limitation possible

V. Other developments



Other developments

- Remove QFII quota
- Trial of PRC digital currency DC/EP
- New holiday arrangement – 4 1/2 working days
- REITs pilot reform
- China Depository Receipt (CDR) standard lowered
- New infrastructure: 5G, IoT, industrial internet, satellite internet, AI, cloud computing, blockchain, ….

VI. Prospects after the pandemic

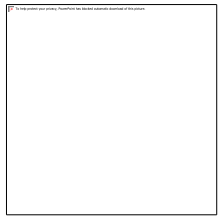


Post-pandemic prospects

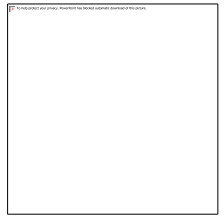
- Further promoting market based allocation regime – land, employment, capital and data
- Phase 2 trade agreement?
- G2 or G0?
- No border for virus
- Global collaboration is a must to finally contain the virus

Thank you

Any questions?



Windson Li
Head, Tax Group, China
DLA Piper, Beijing
windson.li@dlapiper.com
T: +86 10 8520 0609



Peng Tao
Foreign Legal Consultant, Tax
DLA Piper, Hong Kong
peng.tao@dlapiper.com
T: +852 2103 0511

This information does not, and is not intended to, constitute legal advice. All information, content, and materials are for general informational purposes only. No reader should act, or refrain from acting, with respect to any particular legal matter on the basis of this information without first seeking legal advice from counsel in the relevant jurisdiction.