China has issued the Implementation regulations of the Foreign Investment Law to make the legal system for foreign investment clearer.

In brief

On 15 March 2019, the 2nd session of the 13th National People’s Congress (NPC) approved the <Foreign Investment Law of the People’s Republic of China (PRC)> (hereinafter referred to as the “<Foreign Investment Law>”) that sets forth uniform regulations on the access, facilitation and protection, etc., of foreign investment and establishes the basic framework of China’s new legal system for foreign investment. To clarify and refine the major legal system established by the <Foreign Investment Law> as well as to ensure the implementation of the <Foreign Investment Law>, on 26 December 2019, Premier Li Keqiang signed Decree No.723 of the State Council to release the <Implementation Regulations of the Foreign Investment Law of the PRC> (hereinafter referred to as the “<Implementation Regulations>”), which clarify the principle-based provisions and requirements of the <Foreign Investment Law> and come into force concurrently with the <Foreign Investment Law> from 1 January 2020. The issuance of the <Implementation Regulations> offers a strong legal protection for the continuous optimisation of foreign investment environment and the promotion of opening-up at a higher level.

In the issue of China Tax and Business News Flash published in March 2019, we provided our detailed interpretation on the <Foreign Investment Law>. Subsequently in this issue of China Tax and Business News Flash, we will analyse the important issues covered in the <Foreign Investment Law> and further clarified by the <Implementation Regulations>, including: the basic issues for foreign investment, guarantee of equal treatment to domestic enterprises and foreign-invested enterprises (FIEs), strengthening of foreign investment protection, regulation of foreign investment, transitional arrangement for existing FIEs as well as law application to Hong Kong, Macao and Taiwan investors, and share with you our observations.

In detail

Consisting of six chapters and 49 articles, the <Implementation Regulations> further clarify and refine the major legal system of the <Foreign Investment Law>, following the layout of the <Foreign Investment Law>.

Clarify the basic issues for foreign investment

Apart from proposing to encourage and promote foreign investment, protect the legitimate rights and interests of foreign investors, regulate the foreign investment and optimise the foreign investment environment, the <Implementation Regulations> also clarify that:

- Foreign investors can jointly invest with other investors, including Chinese natural persons;
- Application of laws and regulations for FIEs to make investment in China; and
- Formulation and adjustment procedures of the negative lists for foreign investment.
The clarification that "foreign investors can jointly invest with Chinese natural persons" addresses the practical issue upon the promulgation of the <Foreign Investment Law> - whether Chinese natural persons can co-establish FIEs together with foreign investors. The clarification that "domestic investment by FIEs in China shall be subject to the <Foreign Investment Law> and its <Implementation Regulations>" indicates that China will adopt the "see-through principle" to conduct supervision over the reinvestment of FIEs in China treated as foreign investment, which is also in line with the <Foreign Investment Law>, providing that "foreign investment" includes "indirect investment activities".

In 2018 and 2019, the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOC) revised the National Negative List for Foreign Investment and the Negative List for Foreign Investment in the Pilot Free Trade Zones (PFTZs) to introduce new opening-up measures and to continue carrying out certain projects on a pilot basis in the PFTZs, demonstrating China’s positive attitude towards the new round of opening-up. On 30 October 2019, the State Council issued the <Opinions on Further Effectively Utilizing Foreign Investment> (Guo Fa [2019] No. 23), which proposes to keep shortening the National Negative List for Foreign Investment and the Negative List for Foreign Investment in the PFTZs, and removing the restriction that the shareholding ratio of foreign investment in securities companies, securities investment fund management companies, futures companies and life insurance companies does not exceed 51% in 2020, indicating China will step up the relaxation on the shareholding ratio of foreign investment in the financial sector. A few days ago, the NDRC officials have said the negative lists for foreign investment will be revisited in 2020 to allow more sectors open to wholly foreign-owned enterprises.

**Ensure equal treatment to domestic enterprises and FIEs**

The Chapter “Investment Promotion” of the <Foreign Investment Law> sets forth principle-based provisions on equal treatment to FIEs while the <Implementation Regulations> further give more detailed rules to ensure equal treatment to domestic enterprises and FIEs, including:

- Government departments shall lawfully treat FIEs and domestic enterprises equally in the aspects of government funding arrangements, land supply, tax relief, qualifications and permits, standard formulation, project declarations, human resources policies, and publish the supportive policies for enterprises’ development to public in accordance with laws.
- FIEs shall equally participate in formulating and revising the national standards, industry standards, local standards and group standards in accordance with laws, and may submit suggestions for establishing the standards to the competent departments; the mandatory standards formulated by the state shall apply to domestic enterprises and FIEs equally, and it is not allowed to set higher technical requirements than the mandatory standards specifically for FIEs;
- Government departments shall not obstruct or restrict any FIEs’ entry to the government procurement market in the corresponding areas and industries freely and give differential or discriminatory treatment to FIEs. FIEs can also raise inquiries, doubts and complaints in accordance with laws and regulations, such as the <Government Procurement Law of the PRC>; and
- FIEs may lawfully conduct financing through public offering of shares, corporate bonds and securities, public offering or private placement of other financing instruments, and external debts within or outside China.

In addition to ensuring equal treatment to domestic enterprises and FIEs, the Chapter of “Investment Promotion” also provides that the state encourages and guides foreign investors to invest in particular industries, fields, and regions. Where foreign investors expand their investment in Mainland China using the profits from their investment in Mainland China, they are allowed to enjoy the preferential policies. On 30 June 2019, the NDRC and MOC released the revised <Encouraged Industry Catalogue for Foreign Investment (2019 Version)> to further expand the scope for encouraging foreign investment. According to the prevailing policies, FIEs investing in the industries of the encouraged catalogue can enjoy fiscal, land use and other preferential treatments; The above-mentioned policies together with the <Notice Regarding the Provisional Deferral Treatment for Withholding Tax on Direct Re-investment of Foreign Investors Using Profits Distributed from Tax Resident Enterprises in China> (Cai Shui [2018] No.102) issued in September 2018, reflect China’s determination to proactively attract foreign investment and to encourage foreign investors to expand investment in China.

**Strengthen the protection of foreign investment**

In order to strengthen the protection of foreign investment, the <Foreign Investment Law> sets the chapter for investment protection. On this basis, the <Implementation Regulations> further refine the policies in the followings aspects:

- Where in the special circumstances the state needs to expropriate foreign investors’ investments for public interest in accordance with laws, they shall promptly make compensation of the expropriated investments at the fair market value by following the legitimate procedures and non-discriminatory methods. Foreign investors dissatisfied with the expropriation decisions may apply for an administrative review or file an administrative lawsuit in accordance with laws.
- Currency, amount, and frequency of remittance must not be illegally restricted by any unit or individual. Salary and other legitimate income of FIEs’ foreign employees and employees from Hong Kong, Macao, and Taiwan can be freely remitted outside Mainland China.
- The state is to increase penalties for infringement of intellectual property rights (IPR), promote the establishment of rapid collaborative protection mechanisms for IPR, refine the diversified dispute resolution mechanism for IPR disputes, and give equal protection to the IPR of foreign investors and FIEs.
It is prohibited to force foreign investors or FIEs to transfer technology by administrative means; administrative authorities and their staff shall strictly protect the business secrets of FIEs obtained during their duties;

Local people’s governments and their relevant departments shall not breach or renounce agreements for the reasons, such as adjustment of administrative regions, government transitions, institutional or functional adjustments, or changes to in-charge personnel; where it is necessary to change policy commitments or agreements for national or public interest, they shall give fair and reasonable compensation to foreign investors or FIEs for any loss sustained as a result; and

The establishment of the complaint mechanism for FIEs and its duty and operation are also clarified. For instance, establishing the inter-ministerial joint meeting mechanism for FIEs, guiding and supervising the local departments to deal with FIEs’ complaints, as well as improving and publicising the rules, methods and timelines for handling complaints.

The establishment of the complaint mechanism for FIEs is conducive to solving the problems encountered by FIEs or their investors. When their legitimate rights and interests are violated, the complaint mechanism for FIEs provides an alternative legitimate method to solve their problems, apart from applying for administrative reviews or filing administrative lawsuits. Regarding the implementation of the complaint mechanism for FIEs, we are still waiting for the clearer and more specific guidelines to be issued by the competent departments of commerce.

Regulate foreign investment
In terms of regulating the foreign investment procedures, the <Implementation Regulations> also clarify:

- Where approval or record-filing is required for foreign-invested projects, it shall be subject to the relevant national regulations;
- The registration of FIEs shall be handled by the market regulatory authority under the State Council or its authorised market regulatory authorities under the local people’s governments; the market regulatory authority under the State Council shall publish the list of its authorised market regulatory authorities; and
- The information reporting of foreign investment shall follow the principle of necessity, efficiency and convenience, and the content, scope, frequency and specific procedures shall be published by the competent departments of commerce jointly with the market regulatory authority under the State Council; It is not allowed to require foreign investors or FIEs to submit their investment information that is available through information sharing among different departments repeatedly.

The <Implementation Regulations> reiterate the requirement of “establishing the security review system for foreign investment” in the <Foreign Investment Law>, but do not provide more detailed articles. To implement the information reporting system of foreign investment, the MOC issued the <Measures for Information Reporting of Foreign Investment> (MOC & SAMR Order [2019] No.2) and the <Public Notice Regarding Certain Matters on Information Reporting of Foreign Investment> (Public Notice [2019] No. 62) on 31 December 2019 to elaborate the scope, subject, content and methods for information reporting of foreign investment, providing clearer guidelines for foreign investors and FIEs to fulfil their information reporting obligations.

Transitional arrangement for existing FIEs
According to the <Implementation Regulations>, the existing FIEs established under the “Three FIE Laws” can adjust their organisational forms and structures and perform alteration registrations, or retain their original organisational forms or structures in accordance with the <Company Law> and the <Partnership Enterprise Law> within 5 years upon the <Foreign Investment Law> taking effect. From 1 January 2025, the market regulatory authorities will not handle other registration matters of the existing FIEs if they fail to adjust their organisational forms and structures and perform alteration registrations in accordance with laws and regulations, resulting in their relevant situations publicized. Meanwhile, after the existing FIEs adjusting their organisational forms and structures, the share or equity transfer, profit distribution, and residual property distribution methods for the original joint ventures and partners will continue as agreed.

Law application to Hong Kong, Macau and Taiwan investors
Under the “Three FIE Laws”, in principle, investments from Hong Kong, Macau and Taiwan are regulated as foreign investment. The issue of law application to Hong Kong, Macau and Taiwan investors is not stipulated in the <Foreign Investment Law>. In order to maintain the continuity and stability of regulatory policies for Hong Kong, Macao and Taiwan investments, the <Implementation Regulations> provides that, unless otherwise specified by laws and regulations, investors from Hong Kong Special Administrative Region and Macao Special Administrative Region shall refer to the <Foreign Investment Law> and its <Implementation Regulation> for their investments in Mainland China; Investors from Taiwan are subject to the <Law of the PRC on the Protection of Investment by Taiwan Compatriots> and its detailed implementation rules; the unspecified matters shall be implemented by reference to the <Foreign Investment Law> and its <Implementation Regulations>, which give a “reassurance” to Hong Kong, Macao and Taiwan investors.

The takeaway
As a supporting administrative regulation for the <Foreign Investment Law>, the <Implementation Regulations> further elaborate the principle-based provisions in the <Foreign Investment Law> to enhance its practicability, which empowers institutional guarantee for proactively promoting foreign investment, protecting the legitimate rights and interests of foreign
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investment and regulating foreign investment. We also note that the important issue of law application to an investor who changes his/her nationality is not clarified in the <Implementation Regulations>. With the increasing number of Chinese citizens immigrating overseas, after Chinese citizens acquire foreign nationalities and lose Chinese nationality as a result, shall the <Foreign Investment Law> be applied to enterprises that have been already established in China before they change their nationalities? Similarly, for natural persons who have acquired Chinese nationality and renounced their foreign nationality, it remains uncertain whether the <Foreign Investment Law> is still applicable to enterprises that have been already established in China before they change their nationalities.

The relevant provisions of “contractual control relationship (VIE structure)” in the <Foreign Investment Law (Discussion Draft)> have been removed from the <Foreign Investment Law>, but the miscellaneous clause of “other approaches of investment stipulated in the laws, administrative regulations or circulars of the State Council” is retained. The <Implementation Regulations> do not provide more details on the miscellaneous clause, leaving VIE structure arrangements and practical issues in a “Grey Area”. In addition, as a highlight of the <Implementation Regulations (Discussion Draft)> issued in November 2019, the clause of “the round-trip investment of wholly-owned enterprises established overseas by Chinese investors is not subject to the negative list for foreign investment” was finally deleted from the <Implementation Regulations>. It still remains to be seen whether the competent departments of commerce will issue departmental regulations or circulars to clarify the overseas round-trip investment exempt from the negative list administration.

To implement Guo Fa [2019] No.23, the Supreme People’s Court issued the <Interpretation on Several Issues by the Supreme People’s Court Regarding the Application of the Foreign Investment Law of the PRC> (Judicial Interpretation [2019] No. 20) on 26 December 2019. The MOC, NDRC and the Ministry of Justice are also thoroughly cleaning up the relevant regulations not in line with the <Foreign Investment Law> and its <Implementation Regulations>, to execute the <Foreign Investment Law>. PwC’s China Business & Investment Advisory Team will continue to follow the future development of the supporting policies and regulations of the <Foreign Investment Law> and share our observations in a timely manner.

Endnote

1. For the <Foreign Investment Law of the People's Republic of China>, please refer the official link: http://www.gov.cn/xinwen/2019-03/20/content_5375360.htm
2. For the <Implementation Regulations of the Foreign Investment Law of the People's Republic of China> (Decree No.723 of the State Council of the PRC), please refer to the official link: http://www.gov.cn/zhengce/content/2019-12/31/content_5465449.htm
4. For the <Opinions of the State Council on Further Effectively Utilizing Foreign Investment> (Guo Fa [2019] No.23), please refer to the official link: http://www.gov.cn/zhengce/content/2019-11/07/content_5449754.htm
9. For the <Interpretation on Several Issues by the Supreme People’s Court Regarding the Application of the Foreign Investment Law of the PRC> (Judicial Interpretation [2019] No.20), please refer to the official link: http://www.npc.gov.cn/npc/c30834/201912/c1c0c5a2b7c44e66bd9eb7829cf71af5.shtml
Let’s talk

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PwC’s China Business & Investment Advisory Team specializes in China regulatory advisory and implementation work, ranging from market entry solutions, structure set-up, foreign exchange solutions, to restructuring solutions, e.g., equity transfer, merger and liquidation, etc. The team maintains close dialogues with various Chinese approval and registration authorities as well as industry bureaus at central and local levels. It also has extensive involvement and experience in advising clients on business cases from both the regulatory and practical perspectives.
In the context of this News Flash, China, Mainland China or the PRC refers to Mainland China, and excludes Hong Kong Special Administrative Region, Macao Special Administrative Region and Taiwan Region.

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