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Review: Law China 2024 and outlook for 2025

The year 2024 is coming to an end and we have experienced some important changes in business law and related areas in China. This is no surprise. Although the gross domestic product is expected to grow at a comparatively comfortable rate of 4.6% in 2024, there are signs of troubled waters ahead: domestic demand for consumer goods remains weak, youth unemployment is extremely high and investors from abroad have been

exercising caution in view of the politically difficult situation we continue to observe in China.

Against this background, many changes in the law are understandable. Some of them have a protectionist nature, others are simply following worldwide trends, for example with the data protection law.

Adjustments to corporate law



Capital contribution timeline

The biggest changes here can be found in the core subject: corporate law. China has decided to take what we believe to be a regrettable step. Under the old law, the promised capital had to be paid within the operative term of the company (approximately analogous to the German law "injection upon request of the management"). Under the new law the capital must be paid within five years.

In other words, where originally the share capital only meant the promise to settle any debts up to this amount, the new law forces investors to make a real investment: they have to pay the promised capital, even if they find out that they don't need this investment, in which case it would make no economic sense to transfer the capital to China and deprive the parent company of liquidity.

Yes, the new law seems to comfort the investor with a simplified way for companies to reduce capital. But here's the kicker: as a rule, this does not help investors who have promised capital in an investment agreement with a Chinese investment zone, with the understanding that they can then benefit from government subsidies in exchange. And, as described above, the investor had promised this with good faith according to the former law, i.e., an actual deposit only if necessary. In other words, a reduction in share capital is possible, but if implemented accordingly, it is likely to lead to conflicts with the investment authorities and, eventually, to at least a partial repayment of subsidies received.

✓ To Do: It is advisable to check the capital structure with regard to non-paid-in capital. If there is unpaid capital, we recommend forecasting whether this capital will be required in the next five years or not. We recommend calculating an overall updated financing plan to address the new capital contribution requirement as introduced by the new law.

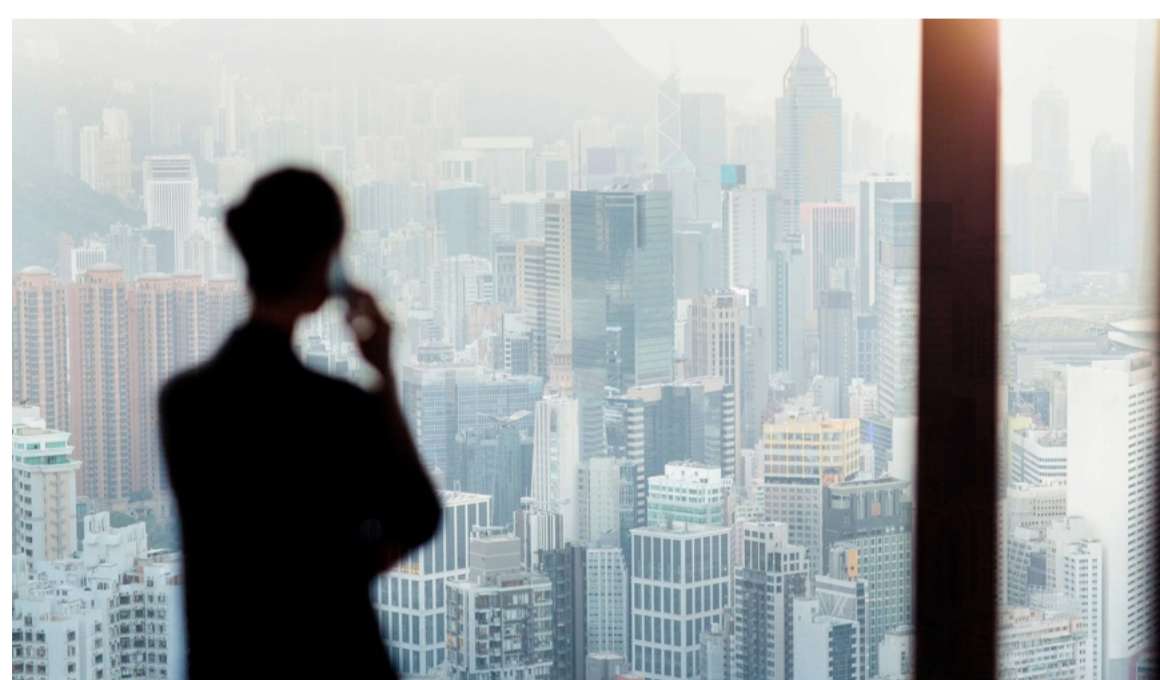
End of the transitional period for corporate structure change

With the introduction of national treatment, where foreign entities will be treated in the same manner as domestic ones, foreign investors were given a five-year transitional period to complete corporate structure changes with respect to their investments in China so as to be in-line with the Company Law that applies generally to all limited liability companies nationwide. By the end of 2024, the said five-year period will expire.

Major corporate structure changes that are contemplated thereby include, for example, the highest decision-making authority of a Sino-foreign joint venture to be changed from the board of directors to a shareholders' meeting, and consequently the powers and responsibilities among different internal organs to be reallocated.

✓ To Do: We suggest action be taken at the earliest convenience to meet the prescribed timeline, especially for foreign investors who hold interest in joint ventures. Changes can be done by way of article amendments followed by a registration update with local corporate registration authorities. We always remain at your disposal.

Key personnel are now subject to a higher code of conduct: Implications for corporate and criminal law



Amidst the shift in attitude towards tighter regulations with respect to directors, supervisors and senior management personnel, both the new Company Law and the latest amendment to the Criminal Law of China, which came into effect this year, allow for extra civil and criminal liabilities to be attributed to the aforementioned positions (as well as to the "de facto director" and "shadow director" positions) in the case of certain types of wrongdoing.

For example:

- The new Company Law elaborates further on the long-established principles of loyalty and diligence. Examples of behaviors that amount to a breach thereof are specifically stipulated in the new law. This includes operating competing businesses and soliciting business opportunities from companies, which would be regarded as a breach of the duty of loyalty adequate where such acts have been approved by adequate internal decision-making authorities.
- Henceforth, the conduct of related-party transactions will be subject to a stricter procedural requirement. Reporting and approval is now a must-do before the transactions can be implemented. In the meantime, the scope of related parties has been broadened, leaving less room for exemptions to be argued successfully. Directors, supervisors and senior management should

take a more cautious approach when performing their responsibilities.

- Illegal gains received as a result thereof would be forfeited and returned to companies. Liabilities for indemnification may also be triggered.

- As for the criminal law perspective, (a) operating competing businesses; (b) engaging in improper affiliated transactions, such as purchase from or sale to related parties, of products or services at a price significantly higher or lower than the applicable market price, in each case, by leveraging the powers and authorities vested in the position of director, supervisor or senior management personnel; or (c) disposing assets or properties at a low price, where substantial illegal gains are obtained and material loss to the company is caused, would subject the individuals concerned to criminal liabilities.

✓ To Do: No action is needed for the time being. However, when it comes to internal audits or fraud detection, we suggest that due regard be given to these stricter requirements in the assessment of performance / compliance by individuals holding the affected positions. Furthermore, the selection of individuals to assume these positions can become more challenging, requiring careful evaluation when decisions are to be made.

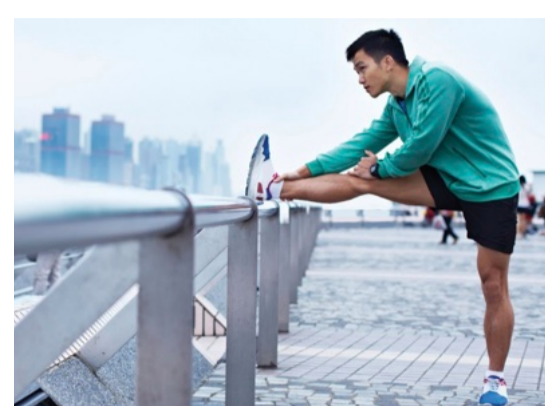
Customs law

The new Customs Tariff Law, which takes effect on December 1, 2024, sets out a range of legal provisions on tariffs on Chinese imports and exports: from the definition of tax incentives to China's right to take action against countries that do not comply with trade agreements. Major highlights encompassed by this new law include, but are not limited to:

- Cross-border e-commerce platforms, logistics companies, and customs declaration firms are designated as tariff-withholding agents
- The customs clearance process is now simplified by separating the release of goods from tariff payments
- An extended period for tax-refund applications
- Countries and regions failing to fulfil most-favored-nation treatment or tariff-preferential treatment clauses in international treaties or agreements with China may face corresponding measures based on the principle of reciprocity

✓ To Do: No action is necessary for the time being, but for any questions regarding the above changes, we are happy to help elaborate and address whatever concerns you may have.

Fair competition law



A new law that prohibits local authorities from granting subsidies in the form of tax remission is highly topical.

Such subsidies are usually provided through investment agreements within the investment zones. Under the old legal framework, tax subsidies could not be granted through decrees but only through reimbursements at the local level. Now it seems that this funding option will also be banned in the future. It is still unclear whether there will be loopholes, but it seems certain that investors will have to prepare for significantly lower subsidies.

It is also unclear whether funding that has already been given has to be repaid. We recently encountered several scenarios where the local authorities indicated such a possibility.

✓ To Do: So far no need for action, but new investors should keep this situation in mind. Once the situation has been cleared up, we will provide an update in a newsletter. In the meantime, a preparatory assessment on potential implications may be initiated. We recommend conducting a preliminary check on the current status of tax-preferential treatments and financial subsidies that local investments are entitled to.

Data protection law

The law on protection of personal data dates back from year of 2021, but according to our observations, it has not been implemented or has only been partially implemented by many foreign invested companies in China. A right to collect and process personal data only exists if there is an express and informed consent from the data subject. Exemptions are found in cases where the conduct of data-processing activities is to fulfill a contract in which the data subject is a party, or to carry out personnel administration, among others. This also expressly applies to companies that are not based in China but which hold data from Chinese citizens with an aim to provide products or services to them or for the purposes of analyzing their behavior.

International data transfer is perhaps the biggest compliance risk for German companies, since for smaller investments, the actual administration and management lies in Germany (note: pay attention to the permanent establishment!). It is also worth mentioning that data export to foreign regulators will now require approval from the competent authorities.

Having said this, we observed a legal trend to relax the administrative procedural burden that was previously exerted on the personal data exporter. One of three well-known procedural requirements needs to be followed before personal data can be transferred abroad: (1) a security review, (2) a personal information protection certification, or (3) the execution of a cross-border data transfer contract.

Now, an extensive list of exemptions has been implemented following the entry into effect of the new rules on data export. To name a few:

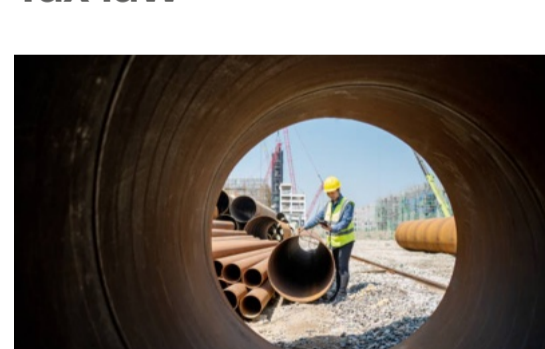
- Carrying out cross-border human resources management in the company
- Fulfilling a contract to which the data subject is a party; this covers a wide range of cross-border activities (e.g., shopping, courier, payments, opening a bank account, visa applications)
- Non-sensitive personal information transfers by data handlers who are not critical information infrastructure operators, when the aggregate volume of data to be exported is less than 100,000 data subjects within the current year
- Conducting international trade, cross-border transportation, academic cooperation, cross-border production and manufacturing, and marketing, if no important data or personal information is involved in the export

Kindly note that the exemptions from the aforementioned procedural requirements do not release data handlers from complying with other existing requirements, including obtaining of separate prior consent, completion of pre-export impact assessment, and the full disclosure of information regarding the recipient(s).

Failure to comply can result in severe penalties, both for the company (up to 5% of annual revenue) and for the people involved (up to one million RMB).

✓ To Do: We can provide support with a data-protection health check, which we highly recommend since the topic was previously not on the agenda of Chinese authorities, but has now become very sensitive. We have observed that many foreign invested companies in China did not check the compliance of their operational structure with the data protection law.

Tax law



Almost every week we hear from the tax offices that there is no change in the law, but an important change in the application of applicable laws, including double-taxation agreements, arises. Municipalities are cash-strapped and tax policy at the local level is becoming increasingly rigid. Tax-refund applications are very difficult to get through, even when the facts are clear. We have seen cases in which municipalities have requested that subsidies from previous years be paid back.

✓ To Do: Tax planning is even more important today, especially when working across borders or for those individuals with dual residence.



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