

## Tax Analysis

### China passes export control law

On 17 October 2020 the Standing Committee of the National People's Congress, China's top legislature, passed the "Export Control Law of the People's Republic of China" (new law). The new law is effective from 1 December 2020 and provides the basic legal framework for China's export control affairs.

Export control is not new in China as certain laws and regulations historically have been in place to control the export of dual-use and nuclear/military-related items. However, these laws and regulations are not cohesive and, in some cases, have not been updated in almost ten years. The new law consolidates the various measures and introduces amendments and new provisions.

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#### Scope of export control

##### *Controlled items*

The following items are subject to export controls (i.e., controlled items):

- Dual-use items;
- Nuclear items;
- Military items; and
- Other items to protect national safety and interests or fulfil obligations under international agreements.

The term "items" refers to goods, services, technology, and relevant data. Furthermore, "dual-use items" are defined as items that can be used for civil applications as well as military applications or military potential enhancement, particularly those that can be used for the design, development, manufacture, or enablement of weapons of mass destruction (including vehicles to transport such weapons for the intended use).

### *Export activities*

The following activities are subject to export controls:

- The transfer of controlled items from China to foreign jurisdictions; and
- The provision of controlled items to foreign parties by Chinese entities or individuals.

With respect to the transfer of controlled items from China to a foreign jurisdiction, the transferor can be a Chinese or foreign entity or individual.

The provision of controlled items to foreign parties includes deemed export activities. For example, controlled items provided by a Chinese entity or individual to Chinese representatives of a foreign entity or a foreign individual physically present in China could be considered an export activity subject to controls.

The new law also provides that "re-exports" of controlled items fall within the scope of export activities subject to controls; however, as yet there has not been clarification about the activities that constitute re-exports.

### *Miscellaneous provisions*

The new law also introduces new provisions including the following:

- If a foreign entity or individual violates the new law and endangers China or its interests, such entity or individual will be dealt with according to the new law (although it remains to be seen how this will be enforced);
- For any foreign jurisdiction that implements export control measures that endanger China's national safety and interests, China may implement reciprocal measures against the jurisdiction; and
- Service providers may not provide agency, freight forwarding, courier, customs declaration, e-commerce platform, or financial services in connection with export activities that are not compliant with the export control laws, otherwise such providers may be subject to penalties.

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## Export license requirements

The government (through relevant government departments) will continue to maintain a list specifying controlled items, which are subject to an export license requirement. Currently for example, the list of controlled dual-use items is prepared by the Ministry of Commerce (MOFCOM) and the General Administration of Customs (GAC) and updated annually. The relevant government departments, such as MOFCOM for dual-use items, administer the licenses, including approvals and compliance matters.

The relevant government departments also may introduce a temporary license requirement for the export of certain items not yet on the list if such department determines that a license control is necessary, subject to the following rules:

- An announcement must be made in respect of such items indicating that a temporary license is required but that the items are not on the list of controlled items;
- The term of the temporary control measure may be up to two years (although renewals are permitted); and
- Before the expiration of the term, the department must determine whether a license is no longer required for such items, to renew the control measure, or to move the items to the list of controlled items.

For export of items that are not on the list of controlled items or subject to a temporary license requirement, the exporter must still obtain approval to export such items from the relevant government department if it either receives a notice to that effect from the department or knows (or should know) such exports may give rise to the following risks:

- The exports may endanger China's national safety or interests;
- The items may be used for the design, development, manufacture, or enablement of weapons of mass destruction (including vehicles to transport such weapons for the intended use); or
- The items may be used for terrorism purposes.

If the exporter is unable to determine whether it must obtain approval to export a specific item, the exporter may consult with the relevant government department.

## End use of controlled items

A key factor that the government departments consider when deciding whether to grant a license is the end use or end user of the controlled item. Any change to the end use or end user of the controlled item must be reported by the exporter or (foreign) importer in a timely manner to the relevant government department.

The government also maintains a deny list of importers and end users that are prohibited from trading in controlled items. Exporters generally are not allowed to trade with such importers and end users unless special approval is granted.

Importers and end users may be added to the list if they are involved in:

- Activities that are not in compliance with the new law as to the management of the end users or end use of the controlled items (e.g., the items being actually used for purposes different from the end use previously reported to obtain the export license, without such change being reported);
- Activities that may endanger China's national safety or interests; or
- Terrorism activities.

Importers and end users placed on the deny list may apply for removal from the list after they have taken remedial actions and the relevant government department has approved their removal from the list.

## Investigations

The government departments may initiate an investigation against an entity or individual that is suspected of noncompliance with the export control laws. The investigator may take the following actions:

- Inspect business premises or other relevant places;
- Question the relevant parties and request statements;
- Review and copy documents, accounting records, mail, and other correspondence;
- Inspect transportation vehicles used for exports, issue orders to cease loading and/or return the relevant goods;
- Detain the relevant goods; and
- Obtain bank account information.

Where exports are suspected to be controlled items without an export license, the customs authorities may hold the goods and question the exporter. Unlike previous rules where only the exporter could apply to MOFCOM for certification about whether the concerned goods are controlled items, the new law authorizes customs authorities to request the relevant government department to make such a determination.

## Penalties

The new law increases the penalties for noncompliant activities. Under the previous rules, the fine for exporting controlled items without a license could not be higher than CNY 1 million or 30% of the value of the goods. Under the new law, the fine can range from CNY 500,000 to ten times the export revenue (i.e., the amount paid for the goods). In addition, the export revenue may be confiscated, and the business permanently prohibited from engaging in the export of relevant items in serious cases.

Penalties have been added for certain noncompliant activities, which include:

- Trading with deny listed importers or end users. This activity may subject the exporter to warnings, orders to cease trading, confiscation of relevant income, monetary penalties of up to 20 times the relevant income, with the business potentially being prohibited from engaging in the export of the relevant items in serious cases; and
- Providing services (e.g., agency, freight forwarding) with respect to certain exports that the service provider knows are noncompliant. This activity may subject the service provider to warnings, orders to cease business, confiscation of relevant income, and other penalties.

## Voluntary compliance

The new law states that the government may issue guidance encouraging exporters to establish internal control systems for compliance purposes. Exporters with sound and effective internal control systems may benefit from less scrutiny from government departments and being granted a license permitting multiple exports of controlled items within a set period. Normally, an export license can only be applied on a single transaction basis.

## Comments

The new law signals the Chinese government's intention to improve trade policy from the perspective of national safety and interest. The introduction of new rules (e.g., the deny list of importers and end users) and the increased penalties for noncompliance clearly present more risks to exporters.

Affected businesses should consider establishing sound and effective internal control procedures to ensure compliance with the various export control requirements. MOFCOM issued guidance in 2007 addressing company policy, organizational support, internal review procedures, internal guidance, training, and documentation to guide businesses in establishing such procedures. This guidance is expected to be updated after the new export control law comes into effect.

Affected businesses should take the following steps as early as possible:

- Identify areas where export control measures apply and compliance procedures should be in place;
- Review current internal control systems and update as necessary, along with considering automated solutions;
- Provide trade compliance training to employees; and
- Analyze the overall impact of the new law on current products, business models, and company strategies, and determine whether any changes should be made.

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