

## Tax Analysis

### China invites public comments on draft regulations on export control of dual-use items

In late April 2022 China's Ministry of Commerce (MOFCOM) published draft regulations on export control of dual-use items for public consultation purposes. The draft regulations are another significant step towards improving China's export control regime following the start of the Export Control Law (the law) on 1 December 2020.

This article provides a high-level summary of the key aspects of the draft regulations, as well as our observations.

#### Scope of application

The draft regulations generally apply to exports of dual-use items, which are defined in the law as items that can be used for civil applications as well as military applications or military potential enhancement. The term "items" refers to goods, services, technology, and relevant data.

The draft regulations, if finalized and implemented as published, will revise, consolidate, and supersede current regulations on export control of most dual-use items (e.g. nuclear dual-use items, missiles and related items, biological dual-use items, etc.). The current regulations for controlled chemicals, subject to any future updates to align them with the law, are expected to continue to provide special rules for the export of controlled chemicals. However, certain general rules in the draft regulations may also apply to such exports.

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The draft regulations will apply also to exports of other items requiring control because of the need to protect national safety and interests or to fulfill obligations under international agreements, unless other laws or regulations provide otherwise.

### Dual-use items list and coding system

The draft regulations provide that the MOFCOM will develop and publish a list of dual-use items that are subject to export controls. The list may replace the current catalogue of controlled dual-use items. A coding system will be introduced to assign a unique code for each dual-use item on the list.

The current catalogue contains the names and descriptions of each controlled dual-use items, as well as the relevant HS codes where such items are tangible goods. However, the lack of codes for intangible items can make the catalogue inconvenient to use for items such as certain technologies or services that are subject to export controls. In 2021, MOFCOM published an article on its website that briefly mentioned a five-character alpha-numeric coding system other countries have adopted for export control purposes. This has led to speculation that the MOFCOM will introduce a similar coding system in China for export control purposes.

### Destination countries/regions control

The law provides that Chinese government authorities will evaluate the risk levels according to the export destination countries or regions of dual-use items and apply control measures accordingly. In other words, the control measures can vary depending on export destination.

The draft regulations list the factors to be considered by the government authorities when evaluating risk. These are the impact on national safety and interests, the need to fulfill obligations under international agreements, foreign policy needs, and cooperation with China in relation to export controls, etc.

### Licensing scheme

The current licensing scheme is retained in the draft regulations, where any export of dual-use items is generally subject to a license requirement. There are two types of licenses: a single license that only allows a single export of one specified type of dual-use item to one end user within the valid period of the license; and a general license that allows multiple exports of multiple specified types of dual-use items to multiple destination countries/regions or end-users within the valid period of the license.

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*a. Valid period*

The valid period of single licenses is generally one year or less. The valid period of general licenses is two years, reduced from three years under the current rules.

*b. Application materials*

The draft regulations unify the list of documents or information required to apply for export licenses. Information about the foreign importer and the end-user is newly added to the list by the draft regulations.

*c. License exemption*

The draft regulations list the following situations where there may be exemption from the export license requirement:

- The item was imported into China for purposes of repair, experiments or testing, and then within a reasonable period shipped back to the place from which the item was originally exported to China;
- The item was imported into China for display in an exhibition held in China and then, immediately after the exhibition, shipped back in its original condition to the place from which the item was originally exported to China;
- Exports of components of civil aircraft to be repaired overseas; and
- Other situations specified by the MOFCOM.

To apply for license exemption, an exporter must register with the MOFCOM prior to the relevant export transactions. Exemption applications may be rejected for exporters that have a record of past export controls noncompliance.

*d. Deny list*

The law requires the government to maintain a deny list of foreign importers and end users that are generally not permitted to trade in controlled items. Chinese exporters can only trade with such importers and end users in special situations. The draft regulations provide that general licenses cannot be granted in such special situations, and that the license exemption rules cannot be applied.

## Reporting obligations

The draft regulations will require Chinese exporters or foreign importers (in the destination countries or regions) to report to the MOFCOM in a timely manner in the following situations:

- Within a three-year period after relevant items are exported, the exporter found the export may give rise to risks of endangering China's national safety or interests, of being used for the design, development, manufacture or enablement of weapons of mass destruction, or of being used for terrorism purposes;
- The exporter found the documents to support the end user or end use were fake, invalid, or obtained through illegal means (e.g. cheating, bribery, etc.); and
- The exporter or the importer found the end user or end use had been changed or could potentially be changed.

For an entity or individual that provides services to relevant exporters or importers (e.g., freight forwarding, agency, customs declaration, e-commerce platform services, financing, etc.), the draft regulations will require them to immediately stop the services and inform the MOFCOM about any noncompliant activities by exporters; otherwise the service provider may be subject to penalties.

### Miscellaneous

According to the draft regulations, a cross-department mechanism, involving the MOFCOM, the Ministry of Foreign Affairs, the Ministry of State Security and the General Administration of Customs (GAC), will be established to ensure the enforcement of the law. The MOFCOM and the GAC are the departments that have the right to assess administrative penalties against parties violating the law.

The draft regulations specify the following situations where a lesser or reduced punishment may be given to a party violating the law:

- The party has voluntarily removed the harmful consequences from the violation;
- The party was coerced or trapped into violating the law;
- The party has voluntarily reported violations unknown to the MOFCOM; and
- The party has meritorious conduct.

The draft regulations also provide for lesser punishment for an exporter or service provider violating the law if the entity can demonstrate the effective operation of its internal control system for export control affairs and the harmful consequences of its violations are limited.

### Comments

The MOFCOM released China's first export control white paper in December 2021 and recently launched a dedicated website to publish export control-related official information. The publishing of the draft regulations is another indicator of the rapidly changing regulatory environment for export control in China. Businesses can expect a more aligned and comprehensive export control regime in the future, which will result in higher compliance requirements. Therefore, affected businesses should be closely monitoring regulatory developments, evaluating the potential impact of the relevant regulations, and formulating action plans to manage their export controls compliance effectively.

Chinese government authorities have been encouraging businesses to establish and maintain a well-functioning internal compliance program (ICP) for export control purposes, by granting benefits to businesses that have such ICPs in place (e.g., facilitation to apply for general licenses, lesser or reduced penalties for violations, etc.). Both exporters and other affected parties in supply chains (e.g., relevant service providers) may need to consider establishing ICPs according to the MOFCOM guidelines or review their existing compliance programs to identify areas for improvement.

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