

March 2025

China Tax Lawyer

By Fortran Law Firm

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Editor's Note

In this March 2025 issue of *China Tax Lawyer*, we present a curated selection of legal insights and updates reflecting key developments across China's regulatory and tax enforcement landscape.

We open with an in-depth analysis by Partner Ivy Yang on the enhanced compliance expectations for quantitative funds under the evolving asset management regime. This article dissects new requirements concerning algorithmic trading disclosures, AI oversight, and risk control frameworks—topics of particular urgency amid heightened regulatory scrutiny.

Next, Senior Associate Cassie Chen explores the institutionalization of double derivative actions under the 2023 revision of the Company Law. Her piece traces the legislative journey from judicial experimentation to statutory recognition, highlighting unresolved questions in shareholder standing and group governance structures.

Our case commentary by Legal Assistant Lei Xu examines a recent judicial ruling confirming that patent rights cannot be used as tax collateral. The analysis clarifies the boundary between civil and administrative logic in tax security practices, reaffirming the primacy of statutory authority in public enforcement.

In the regulatory update, Associate Iris Lei summarizes the NFRA's new policy initiative to expand consumer finance. By raising credit limits and extending loan terms, the measures signal a structural shift toward consumption-driven growth, supported by enhanced risk controls and inclusive finance objectives.

We conclude with a brief update on ForTran's recent participation in postgraduate legal training at East China Normal University, underscoring our continued commitment to legal education and knowledge sharing.

We hope this issue offers valuable perspective on China's legal developments from a tax-focused lens.

Insights | Key Compliance Considerations for Quantitative Funds

under the New Regulatory Regime

By Ivy Yang, Partner, ForTran Law Firm

This article provides a comprehensive overview of the compliance requirements for quantitative funds under the latest Chinese regulatory framework, covering fundraising disclosures, algorithmic trading rules, internal control standards, and special supervision of high-frequency trading.

I. Special Compliance Requirements in Fundraising for Quantitative Funds

The fundraising process for quantitative funds is generally aligned with that of other private fund products. However, the key distinction lies in the need for enhanced disclosure of risks specific to quantitative strategies. This issue has become a central point of contention in recent disputes over sharp drawdowns in the net asset value (NAV) of quantitative private funds in early 2024.

According to the *Guidelines on Regulating the Asset Management Business of Financial Institutions* (commonly referred to as the “*New Asset Management Rules*”), financial institutions employing artificial intelligence (AI) technologies in asset management activities must strictly comply with general requirements on investor suitability, investment scope, information disclosure, and risk isolation. Institutions are prohibited from using AI to exaggerate promotional materials or mislead investors.

Financial institutions are required to file key parameters of AI models and the core logic of asset allocation with financial regulators. They must establish segregated intelligent investment accounts for individual investors, adequately disclose inherent flaws and risks associated with AI algorithms, clarify trade execution workflows, implement robust audit trail mechanisms, and closely monitor trading positions, risk limits, permitted trading types, and pricing thresholds of AI-driven accounts.

Therefore, during the fundraising phase, fund managers must provide tailored descriptions and

disclosures of the risks associated with quantitative trading. This includes a proper explanation of the underlying strategy and specific warnings regarding the impact of historical data on algorithmic models—such as data sources, processing standards, and quality differentials, which may materially affect model outputs.

II. Compliance Requirements for Quantitative Trading Activities

(1) Pre-Trade Reporting Obligations (“File Before You Trade” Principle)

(a) Reporting Requirements and Amendments

Algorithmic trading investors (commonly referred to in China as ‘programmatic trading investors’) must submit complete, accurate, and timely reports. Material changes must be promptly updated. Information to be reported includes:

- ◆ **Account Information:** Investor name, securities account number, designated broker or custodian, fund manager, etc.
- ◆ **Funding Details:** Account capital, source and amount of leveraged funds, leverage ratio, etc.
- ◆ **Trading Information:** Strategy type and core mechanics, execution methods, maximum order submission rate, daily order submission limits, etc.
- ◆ **Software Details:** Software name, version, developer, etc.
- ◆ **Other Information:** As required by the stock exchange, including contact information of the investor and the relevant securities firm.

(b) Reporting Process

Clients of securities firms must report through their brokers. Once verified, the broker shall confirm and submit the information to the stock exchange. Entities using independent trading units or other designated systems shall report directly to the exchange. Algorithmic trading may only commence after reporting obligations have been duly fulfilled. Exchanges are required to promptly confirm receipt of the report, periodically screen data for consistency, and may conduct audits on relevant parties.

(2) Trade Monitoring and Risk Management

In 2024, the Shanghai and Shenzhen Stock Exchanges conducted multiple training sessions with leading quantitative private fund managers. These sessions highlighted case studies on abnormal trading behaviors, reiterated compliance expectations, and emphasized the importance of internal controls to mitigate potential market disruptions and ensure stable market operations.

Given the heightened regulatory scrutiny, quantitative fund managers must implement robust internal compliance controls for trading activities. This includes embedding measurable indicators of abnormal trading behavior into algorithmic models. Exchanges have issued guidelines or detailed rules to provide quantifiable standards for identifying irregular trades. For instance, the *Shanghai Stock Exchange* (SSE) has established real-time surveillance measures focused on the following:

- (a) **Abnormal Trading Activities:** As defined in the SSE's business rules, including behaviors that may affect price, volume, or system security. Key categories include:
 - Abnormal Submission Rate: Excessive order submissions or cancellations within a second;
 - Frequent Instant Cancellations: Repeated intraday orders followed by rapid cancellations within a second, leading to high cancellation ratios;
 - Spoofing or Layering: Repeated intraday small price push-ups or downs;
 - Large Block Trades in a Short Timeframe: Massive buying or selling within one minute, impacting benchmark indices (e.g., SSE Composite or STAR 50 Index).
- (b) **High Frequency Thresholds:** Submitting 300+ orders per second or over 20,000 orders in a single day.
- (c) **Broad Market Impact:** Abnormal price or volume fluctuations in multiple securities involving high participation from algorithmic traders.
- (d) **Other Matters:** As deemed necessary by the exchange.

(3) Internal Risk Control Systems

Private fund managers must establish and effectively implement risk control mechanisms for liquidity, concentration of holdings, leverage, trading frequency, basis risk management, factor

exposure, and large block trades executed within short time intervals.

III. Institutional and Procedural Compliance Requirements

(1) Policy Framework

Firms engaged in algorithmic trading must establish dedicated operational, compliance, and risk control policies. Personnel with compliance responsibilities must carry out their duties diligently. Fund managers of quantitative private securities investment funds must design and enforce policies tailored to algorithmic trading, enhance the review and monitoring systems for algorithmic orders, and mitigate operational risks.

(2) Technical System Requirements

Trading systems used by private fund managers must meet the basic functional requirements set by securities exchanges and be fully tested to ensure continuous, stable operations.

(3) Process Implementation

Fund managers must establish and implement comprehensive processes for the development, testing, validation, compliance review, and deployment of algorithmic trading strategies.

(4) Recordkeeping Obligations

Fund managers must retain historical trading records and written documentation of algorithms or strategy rationales for no less than 20 years from the date of fund liquidation.

(5) Protection of IP Rights

Proper mechanisms should be established to protect the intellectual property rights of quantitative algorithms and strategies.

IV. Special Regulatory Measures for High-Frequency Trading (HFT)

High-frequency trading refers to algorithmic trading characterized by:

- (1) High order submission/cancellation rates within short time intervals (e.g., over 300 orders per second per account);
- (2) Large volumes of intraday order activity (e.g., over 20,000 orders per day per account);
- (3) Other characteristics as defined by the exchange.

Regulators have imposed differentiated supervision for HFT, including requirements for additional disclosures such as server locations, system test reports, and contingency plans. Exchanges may impose higher fees on HFT activity and adopt stricter controls to prevent abnormal trading behavior.

Insights | The Evolution, Judicial Rules, and Key Issues of Double Derivative Actions in China

By Cassie Chen

China's Company Law introduced the derivative action mechanism in its 2005 revision. After more than a decade of judicial practice, the 2023 amendment formally incorporated the concept of double derivative actions under Article 189(4), marking a new era in corporate governance litigation. This institutional development is both a response to practical commercial needs and the crystallization of judicial experience. By breaking through the traditional tiered constraints of corporate litigation, the double derivative action establishes a mechanism for piercing relief in parent-subsidiary structures, offering a novel remedy for modern corporate groups.

I. From Concept to Codification: The Legislative Path of Double Derivative Actions in China

Originating in 19th-century Anglo-American common law, the derivative action was designed to empower qualified shareholders to enforce corporate rights when internal governance mechanisms fail—particularly against directors, supervisors, or senior executives. Although China first codified shareholder derivative actions in the 2005 Company Law, the statute remained silent on their applicability in multi-tiered corporate structures.

In 2016, Article 31 of the Draft Provisions IV of the Supreme People's Court on the Application of the Company Law attempted to extend the derivative action to wholly owned subsidiaries. Article 35(2) of the draft explicitly stated that a shareholder could seek redress on behalf of a wholly owned subsidiary but not the parent company. However, due to concerns

over exceeding the interpretative authority granted to judicial interpretations, this provision was ultimately omitted from the final version.

A true breakthrough came with the 2023 Company Law revision. Article 189 now provides that shareholders of a parent company may, upon satisfying statutory requirements such as shareholding duration and pre-suit demand, initiate a derivative action on behalf of a wholly owned subsidiary to pursue liability for harm to the subsidiary's interests.

II. Judicial Practice and Interpretive Approaches Prior to Legislative Recognition

Prior to the codification of double derivative actions, most courts denied standing to parent company shareholders. Nevertheless, a few exceptional rulings—such as those by the Shaanxi High People's Court—permitted such claims under equitable considerations. Now that the 2023 Company Law has formally recognized this mechanism, it provides a clear statutory basis for such actions, and more cases are expected to follow.

Two appellate rulings by the Shaanxi High People's Court demonstrate a rare but notable departure from the prevailing judicial position at the time:

1. **HNA Hotel Holding Co., Ltd. v. Zhao Xiaohai et al.**, [(2016) Shaanxi Min Zhong No. 228]:

The court held that Zhao, a 40% shareholder of the parent company HNA Investment, had standing to file a claim on behalf of the wholly owned subsidiary (Huangcheng Hotel Co.) after the parent failed to act. The court reasoned that denying Zhao's standing would frustrate the legislative purpose of Article 151 and leave the subsidiary's interests unprotected.

2. **Wang Yongfan et al. v. Zhao Xiaohai et al.**, [(2016) Shaanxi Min Zhong No. 255]:

The court affirmed that a parent company shareholder may file suit under Article 151 of the Company Law to recover losses suffered by a wholly owned subsidiary.

III. Key Issues in the Application of Double Derivative Actions

Double derivative actions build upon the foundation of traditional derivative suits but are tailored to address the specific context of group company structures. Several critical issues merit attention:

1. Timing of Shareholder Qualification

According to Paragraph 24 of the Ninth Civil Minutes, a plaintiff's shareholder status must be assessed at the time of filing, not at the time of the alleged misconduct. Accordingly, even if the shareholder acquired their interest in the parent company after the harm to the subsidiary occurred—e.g., through share transfer or capital injection—they retain the right to bring a double derivative action.

2. Loss of Shareholder Status Before Judgment

If a shareholder loses their qualification during litigation—after filing but before judgment—the suit generally becomes moot. Because derivative claims are predicated on the plaintiff's shareholder status, continued litigation would no longer serve a legitimate interest. The Supreme People's Court adopted this position in (2019) Supreme Court Min Shen No. 4358, affirming that loss of shareholder status prior to judgment warrants dismissal of the case.

3. Limitation to Wholly Owned Subsidiaries

Under Article 189, double derivative actions are limited to wholly owned subsidiaries. Shareholders of the parent company do not have standing to bring such suits if the subsidiary is majority-owned or controlled. This structural requirement aims to confine the remedy to circumstances of absolute alignment of interest between the parent and the subsidiary.

4. Judicial Confirmation of Settlements

In accordance with Paragraph 27 of the Ninth Civil Minutes, courts must ensure that any settlement in a derivative action reflects the will of the corporation—the true beneficiary. Courts may only recognize such settlements if approved by the company's internal governance bodies (e.g., board of directors or shareholders' meeting), with the governing body determined by the company's charter. This same rule applies to double derivative suits, given that the ultimate beneficiary is the subsidiary.

IV. Conclusion and Legislative Outlook

The legal rationale behind double derivative actions lies in the chain of economic interest transmission—harm to a subsidiary affects the value of the parent, which in turn damages the

shareholder's investment. In the absence of effective internal remedies within corporate groups, double derivative actions provide a statutory channel for shareholders to supervise and safeguard the interests of wholly owned subsidiaries.

However, the current statutory framework strictly limits applicability to wholly owned subsidiaries and does not address the possibility of derivative claims on behalf of grand-subsidiaries (i.e., second-tier subsidiaries). This has created a systemic loophole: subsidiaries may establish further layers of corporate entities to isolate risks, thereby allowing wrongdoers to leverage the multilayer structure to circumvent accountability. Future legislative refinement is needed to construct a systematic liability framework for corporate groups, particularly by clarifying the scope of derivative standing across multi-layered ownership structures.

Case Commentary | Can Patent Rights Be Accepted as Tax Collateral under China's Tax Security Regime?

By Lei Xu, Legal Assistant, ForTran Law Firm

I. Case Background

On November 4, 2022, the First Inspection Bureau of the Kunming Municipal Tax Service, State Taxation Administration, issued a Tax Treatment Decision following a tax audit of Company A. The decision stated that:

"If your company disagrees with our tax determination, you must first, within the time limit set by this decision, pay the taxes and late payment surcharges or provide a corresponding guarantee."

Company A proposed to pledge its patent rights as a tax guarantee. However, on January 3, 2023, the First Inspection Bureau issued Tax Notification No. [2023] 2, rejecting the application and refusing to confirm the patent rights as acceptable collateral for tax purposes.

Company A filed for administrative reconsideration. The Kunming Municipal Tax Service rendered Reconsideration Decision No. [2023] 4 on April 6, 2023, affirming the original

rejection. Company A then filed an administrative lawsuit against both the First Inspection Bureau and the Kunming Municipal Tax Service. The first-instance court upheld the reconsideration decision. The appellate court dismissed Company A's appeal and affirmed the lower court's ruling.

II. Courts' Reasoning

1. First-Instance Court

The primary issue was whether a patent right could be accepted as a tax collateral under Chinese administrative law system.

The court referred to Article 25 of the Interim Measures for Tax Payment Security (Order No. 11, State Administration of Taxation, 2005), which provides that:

"Tax pledge means that, with the consent of the tax authority, a taxpayer or tax guarantor transfers movable property or certificates of rights into the possession of the tax authority as security for tax and late payment surcharges. If payment is overdue, the tax authority may dispose of the pledged property or certificates in accordance with law. Tax pledges may involve movables or rights. Pledgable rights include bills of exchange, checks, promissory notes, bonds, and deposit certificates. Where the asset exhibits significant value fluctuation, the tax authority at or above the level of a municipality with districts may refuse to accept it as collateral."

The court held that this provision contains an express and exhaustive list of rights-based instruments eligible for tax pledges. Patent rights are not included. Moreover, under Article 1 of the Interim Measures, the regulatory purpose is to safeguard national tax revenue and protect taxpayers' legitimate interests. Unlike civil law, which governs equal private parties, tax enforcement is part of administrative law and prioritizes public interest.

The court emphasized that even pledgable assets may be rejected if they exhibit material value fluctuation, thus reinforcing the administrative discretion afforded to tax authorities. Accordingly, the rejection of the patent pledge by the tax authority was not improper.

2. Second-Instance Court

The appellate court further noted that, to effectively safeguard the enforcement of tax claims and public revenue, assets proposed as tax pledges should ideally:

be capable of being physically possessed or controlled by the tax authority,

be easily realizable,

have stable and ascertainable value,

and be enforceable under administrative procedures.

Patent rights do not meet these requirements.

Additionally, under Article 444 of the Civil Code, a pledge over intellectual property such as patent rights is established only upon successful registration. According to Article 11 of the Measures for the Registration of Patent Pledges (Order No. 56, CNIPA), the National Intellectual Property Administration has discretion to approve or reject a pledge registration within seven working days after receiving the application.

Therefore, even the validity of the pledge itself is uncertain at the time of application. More importantly, in the event of default, the tax authority would not be able to dispose of the patent right directly to offset the tax debt—an essential feature of tax pledge enforcement.

The appellate court confirmed that the tax authority had acted in compliance with administrative procedures prescribed by the Administrative Reconsideration Law and the Rules on Tax Administrative Reconsideration. Accordingly, Company A's appeal was dismissed.

III. Legal Framework and Practical Implications

Article 88 of the Law on the Administration of Tax Collection requires that when a taxpayer disputes a tax determination, they must first pay the tax or provide a legally recognized guarantee before applying for administrative reconsideration. A party dissatisfied with the reconsideration outcome may then bring an administrative lawsuit.

Under Article 2 of the Interim Measures for Tax Payment Security, tax guarantees must be confirmed or accepted by the tax authority. Therefore, the authority has discretion to determine whether the proposed form of security meets legal and practical requirements. A taxpayer cannot unilaterally designate a particular asset—such as a patent—as tax collateral without

such confirmation.

Article 25 of the Interim Measures reiterates this position. Furthermore, Articles 27 and 28 provide detailed procedures for pledging negotiable instruments such as checks, promissory notes, corporate bonds, and deposit certificates. These procedures do not extend to patent rights, and the Measures contain no operational guidance for accepting patents as tax pledges.

In China's civil law system, administrative authorities are strictly bound by the principle of legality (legality of administration). This means that tax authorities may only exercise powers that are explicitly authorized by law or regulation. The categories of assets eligible for tax pledges cannot be expanded through analogy or judicial interpretation.

While the Civil Code does recognize patent rights as pledgable assets in private law relationships, that regime governs contracts and obligations between civil subjects of equal legal standing. It does not apply to administrative enforcement relationships between taxpayers and tax authorities. As the Interim Measures are enacted pursuant to the Law on the Administration of Tax Collection, they form part of the administrative law system and take precedence in matters involving public tax enforcement.

IV. Conclusion

Patent rights are not within the scope of legally recognized collateral for tax payment under Chinese administrative law. Although patent rights are recognized as pledgable assets under the Civil Code, that provision applies to civil relationships between equal parties. Tax collaterals, by contrast, are governed by administrative law and concern the vertical relationship between the state and taxpayers. As such, the rules governing civil pledges under the Civil Code cannot be analogically applied to tax enforcement scenarios, which are governed by different objectives and legal principles.

Tax collaterals in China are subject to strict administrative procedures aimed at ensuring certainty, enforceability, and the realization of state revenue. Accordingly, tax authorities are justified in refusing forms of collateral—such as patent rights—that do not meet these standards. This case reaffirms the primacy of the principle of legality and the limited scope for analogical application in administrative legal practice under China's civil law framework.

Regulatory Update | National Financial Regulatory Administration

Issues Notice on Promoting Consumer Finance to Stimulate Consumption

By Iris Lei, Associate, ForTran Law Firm

The National Financial Regulatory Administration (NFRA) has recently issued the Notice on Promoting the Development of Consumer Finance to Stimulate Consumption (the "Notice"). The Notice sets out 20 specific measures across seven key areas: expanding the supply of consumer finance, enhancing consumer finance management, providing relief through personal consumption loans, strengthening risk control in consumer finance, improving the consumer finance environment, enhancing policy coordination, and reinforcing implementation mechanisms.

It is noteworthy that the Notice implements a policy direction highlighted by NFRA Director Li Yunze on March 5 during the first "Ministerial Corridor" of the 3rd Session of the 14th National People's Congress, where he stated that the NFRA would explore raising the limits and extending the terms of consumer loans.

The Notice allows commercial banks to adopt differentiated credit policies based on customers' repayment capacity and risk profile. For creditworthy customers with large-scale consumption needs, the cap on self-disbursed personal consumer loans may be temporarily increased from RMB 300,000 to RMB 500,000, while the ceiling for personal internet-based consumer loans may be temporarily raised from RMB 200,000 to RMB 300,000.

In terms of loan tenors, for customers with long-term consumption needs, the maximum term for personal consumer loans may be extended on a temporary basis from five years to seven years.

According to the Notice, financial institutions are encouraged to diversify and improve their financial products and services in line with efforts to expand the consumption of goods, develop service consumption, and foster emerging consumption models. Institutions are urged

to develop tailored financial solutions for new consumption scenarios—particularly those involving digital, green, and smart consumption—to better meet personalized and diversified financial demands. Further emphasis is placed on digital enablement to improve the adaptability and accessibility of consumer finance services.

The Notice also calls for targeted allocation of consumer finance resources toward groups such as new urban residents and recent college graduates, and for the improvement of consumer finance offerings in county-level markets. It encourages the piloting of comprehensive consumption and business loans for rural households, accelerating inclusive insurance programs for farmers and low-income urban groups, and promoting comprehensive insurance products for self-employed individuals.

Furthermore, banking institutions are instructed to increase credit support for consumer-facing service sectors, including wholesale and retail, hospitality and catering, culture and tourism, education and training, and healthcare and elderly care. Insurance institutions are encouraged to enhance underwriting support for domestic trade-related insurance to facilitate the efficient flow of goods and services. Banks are also encouraged to coordinate on the structuring of consumer loan credit limits, loan terms, and interest rates. Resource allocation should be optimized to provide preferential pricing for individual consumer loans. Additionally, institutions should establish a due diligence exemption mechanism for consumer loans, improve credit card business management, adopt reasonable standards and rules for credit card overdraft interest, and encourage interest calculation based on actual overdraft balances.

The Notice underscores that banking institutions must adopt a balanced approach combining appropriate regulation and risk mitigation, strictly adhere to risk boundaries, and rigorously assess the authenticity of borrowers' consumption needs and repayment capacity. Institutions must avoid over-lending, multiple credit lines, and fraudulent borrowing. The Notice also emphasizes the need to strengthen independent risk control systems and institutional capabilities to effectively manage consumer finance risks.

Lastly, to enhance consumer protection, banking institutions must standardize contract terms for consumer loans and clearly disclose all cost components to borrowers—including interest

rates, penalties, installment fees, and guarantee fees—ensuring full transparency of the effective financing cost. The inclusion of unfair clauses that undermine consumer rights is strictly prohibited.

Fortran Update

ForTran Lawyers Teach Legal Writing Course for Postgraduates at East China Normal University

In March 2025, Lawyers Ryan Yan, Susan Yang, Daisy Gu, and Summer Qu were invited by the School of Law at East China Normal University to deliver a course on legal writing for postgraduate students. The course covered essential principles and techniques in drafting legal documents, aiming to enhance students' practical legal skills and professional writing competence.